

Injured/Innocent Spouse

Presented by:
Salvatore P. Candela, EA

The TaxAdvocate Group, LLC
(E): scandela@thetaxadvocategroup.com
(T) 877.TAX.1040

DISCLAIMER

This syllabus has been prepared from sources the author believes to be accurate and reliable. The author is not engaged in rendering legal advice. The possibility of human or mechanical error does exist. In addition, the facts and circumstances in an individual's particular situation may not be the same as presented here. Laws, regulations, procedures, etc., frequently change. The users of this syllabus are encouraged to do additional research and fact-finding before relying upon the information contained herein.

© 2018 Salvatore P. Candela, EA, ATA, ABA

No part of this syllabus may be reproduced or stored in retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission of Salvatore P. Candela, EA, ATA, ABA

Salvatore P. Candela, EA, ATA, ABA



Salvatore P. Candela, EA has been preparing taxes since 1986, passed the EA exam in 1997, became an Enrolled Agent in 1998, and a Fellow of NTPI (National Tax Practice Institute) in 2000, and has been a featured speaker around the country.

He is the owner and founder of The TaxAdvocate Group, LLC, which is focused on tax problem resolution and has offices in New York (Queens & Wall Street). His firm aggressively represents taxpayers before all administrative levels of the IRS, and is committed to helping taxpayers resolve their IRS problems – ***Once and For ALL!***

He has almost twenty years' experience in IRS collection proceedings, IRS audits and administrative appeals, and the use of bankruptcy to resolve IRS controversies.

He is a member of the National Association of Enrolled Agents (NAEA), the New York State Society of Enrolled Agents (NYSSEA), the National Society of Accountants (NSA), and the National Association of Tax Professionals (NATP).

He is co-author of the bestselling book "Breaking the Tax Code" and was quoted in a USA Today article about America's Leading Tax Professionals. He has provided tax expertise as a panelist on *Tax Talk Today*, and is an instructor at NTPI.

TABLE OF CONTENTS

| | |
|---|----|
| What is an Injured Spouse? | 1 |
| How is relief applied for? | 1 |
| Allocation Instructions | 2 |
| Special Circumstances..... | 2 |
| Innocent Spouse..... | 4 |
| Introduction | 4 |
| Joint Liability..... | 4 |
| Innocent Spouse Rules | 5 |
| Innocent Spouse Relief under IRC § 6015(b) - General Relief..... | 6 |
| Innocent Spouse Relief under IRC § 6015(c) - Separate Liability | 9 |
| Innocent Spouse Relief under IRC § 6015(f) – Equitable Relief..... | 12 |
| Steps in Handling an Innocent Spouse Case | 23 |

What is an Injured Spouse?

An injured spouse is a taxpayer who has filed a joint return and all or part of their portion of the refund has been, or is expected to be, applied to the other spouse's legally enforceable past due obligations. Examples of these obligations would be past due federal taxes, state taxes, child support, spousal support, or a federal nontax debt, such as a student loan.

The following conditions must apply in order for the taxpayer to apply for injured spouse allocation:

1. The taxpayer is not legally obligated to pay the past-due debt.
2. The taxpayer is reporting income (wages, interest, pension, etc) on the joint return.
3. The taxpayer made and reported payments such as federal withholding or estimated tax payments, or he/she can claim the earned income credit or other refundable credit, on the joint return.

How is relief applied for?

Relief is requested on Form 8379. By filing Form 8379, the injured spouse may be able to get back his/her share of the joint refund.

You can file Form 8379 with the joint return, amended joint tax return, or it can be filed afterwards by itself.

- If you file Form 8379 with the original joint return, attach it in the order of the attachment sequence, but type "Injured Spouse" in the upper left hand corner of page 1 of the joint return.
- If you file Form 8379 separately, you must attach ALL copies of Forms W-2, and W-2G for both spouses, and any Form 1099's showing any federal withholding.
- If you are filing Form 1040X to claim an additional joint refund, then you must complete and attach another Form 8379 to allocate the additional refund.

Allocation Instructions

To properly determine the amount of tax owed and refund due each spouse, an allocation must be made as if each spouse filed a separate tax return instead of a joint tax return. Each spouse must allocate his or her separate wages, business income, pension, social security, self-employment tax, IRA deduction, credits, such as education credits, and withholding to the spouse who would have shown the items on his or her separate return.

Other items that may not clearly belong to either spouse would be equally divided. Examples would be interest on joint bank account and also the early withdrawal penalty on the same joint account.

Allocate the dependent exemptions claimed on the joint return to the spouse who would have claimed them on a separate return.

Allocate any child tax credits, child and dependent care credit, and additional child tax credit to the spouse who was allocated the qualifying child exemption.

Allocate each spouse's separate estimated payments to the spouse who made them. The allocation of joint estimated tax payments can be made in any way the taxpayer and the spouse choose as long as they agree. If they cannot agree, the estimated tax payments must be allocated by the following formula:

$$\frac{\text{Each spouses separate tax liability}}{\text{Both separate tax liabilities}} \times \text{Estimated tax payments}$$

Special Circumstances

Community Property States

If the taxpayer lives in a community property state, special rules will apply to the calculation of the injured spouse claim.

In community property states, refunds are considered joint property and are general applied to the debt of either spouse. However, there are exceptions. The IRS will use each state's rules to determine the amount, if any, that would be refundable to the injured spouse. Under state community property laws, 50% of a joint refund (except the Earned Income Credit (EIC)) is applied to the non-federal tax debts such as child or spousal support, student loans, or state tax debt. However, state law differs on the amount of a joint refund that can be applied to a federal tax debt. The EIC is allocated to each spouse based on each spouse's earned income.

For guidance regarding the amount of a joint refund that the IRS may offset against a spouse's separate tax liability, see the following revenue rulings:

- For Arizona and Wisconsin Rev. Rul. 2004-71
- California, Idaho, and Louisiana Rev. Rul. 2004-72
- New Mexico, Nevada, and Washington Rev. Rul. 2004-73
- Texas Rev. Rul. 2004-74

Innocent Spouse

Introduction

The IRS Restructuring & Reform Act of 1998 provided expanded spousal relief for taxpayers who have filed joint returns. The Act eliminated all of the understatement thresholds of prior IRC § 6013 and requires only that the understatement of tax due go to an erroneous (and not just a grossly erroneous as in the past) item of the other spouse. Also for the first time, taxpayers may seek equitable relief from joint and several liability on joint returns even when the liability resulting from the return filed with a balance due.

As in most IRS representation engagements, understanding the law and being prepared is extremely important. This statement is probably even more accurate when representing a client who is seeking innocent spouse relief. The innocent spouse area is continuing to develop and constant research is necessary to be aware of new cases which are beneficial to (or against) a particular client you are potentially representing. Most innocent spouse cases are factually driven and it is important to fully develop the facts surrounding the claim of the spouse seeking innocent spouse relief. Because there are constant changes in this area, research should be updated when working in this area of representation.

- **Practice Note:** Beware of potential conflicts of interest which will arise when you represent both parties. You may not be able to represent either if you originally prepared the return(s) in question. Circular 230 prohibits individuals who are eligible to practice before the IRS from representing conflicting interests. Despite this prohibition against representing conflicting interests, Circular 230 allows practitioners to represent clients with conflicting interests if, (a) they reasonably believe that they will be able to provide competent and diligent representation to each client; (b) the representation is not prohibited by law and; (c) each client gives informed written consent to the dual representation.

Joint Liability

A married couple may elect to file a joint income tax return even if one spouse has no income or deductions. See Treas. Reg. 1.6013-1(a). The election is made by filing a joint return under IRC § 6013(a).

As Enrolled Agents and tax professionals, we are aware that one of the consequences of filing a joint return is that each spouse is jointly and severally liable for the full amount of tax due. See IRC § 6013(d)(3). This means each spouse is individually responsible for the accuracy and completeness of the return, and the payment of the income tax liability as reported on the return as well as any additional tax, penalties, additions to tax, and interest. If one of the

spouses who signs a joint tax return does not believe he or she should be liable for the full amount of taxes, that spouse may be relieved from liability under the innocent spouse rules.

- **Practice Note:** When preparing or filing a tax return for a married client, if there are any concerns about any position taken on the return such as missing income, questionable deductions, or the ability to full pay the balance due, married filing separate returns should be considered and the consequences of filing a joint return as opposed to married filing separate should be explained to both taxpayers so they can make an informed choice about filing status.

Innocent Spouse Rules

The IRS can grant equitable relief if, under the facts and circumstances, it would be inequitable to hold the spouse liable for and unpaid tax. Relief under IRC § 6015 is available for any tax liability arising under subtitle A of the IRC (income, self-employment, or alternative minimum tax).

- **Practice Note:** Employment taxes on household employees are NOT subject to the relief provisions even though these taxes are reported on and paid with the Form 1040.

IRC § 6015 provides three potential sources of relief to spouses and former spouses that are facing joint and several liability problems:

1. IRC § 6015(b), the “general relief”, provides relief to all joint filers including those that are still married to each other.
2. IRC § 6015(c), the “separate liability election”, covers additional relief available to joint filers who at the time an election is filed:
 - a. Are divorced, or
 - b. Legally separated from the other party to the joint return in question, or
 - c. Have lived apart from the other party for the preceding 12 months.
3. IRC § 6015(f), the “equitable relief”, can be used when neither IRC § 6015(b) nor IRC § 6015(c) applies. The governing procedures for relief under this statute are Rev. Proc. 2013-34 (released September 2013) and Reg. 1.6015-4, and provide guidance on equitable innocent spouse relief, including special conditions for relief.

- **Practice Note:** For “Innocent Spouse” purposes, a deficiency and understatement are the same. A taxpayer who only owes tax based on the return that is filed (an underpayment of tax) is NOT entitled to relief under IRC § 6015(b) and IRC § 6015(c). However under IRC § 6015(f), the innocent spouse can seek equitable relief for underpayment or an understatement of tax.

Innocent Spouse Relief under IRC § 6015(b) - General Relief

A spouse can be relieved of liability for underpayment of tax, penalties, and interest if the following five conditions are met (IRC § 6015(b)(1):

1. The requesting spouse filed a *joint income tax return*. IRC § 6015(b)(1)(A).
2. There is an *understatement of tax* on the joint return attributable to an erroneous item of the other spouse. IRC § 6015(b)(1)(B).
3. The requesting spouse establishes that in signing the return he or she *did not know and had no reason to know* of the understatement of tax. IRC § 6015(b)(1)(C).
4. Taking into account all the facts and circumstances, it would be *inequitable* to hold the requesting spouse liable for joint tax deficiency, penalties, and/or interest. IRC § 6015(b)(1)(D).
5. The spouse claiming relief elects the benefits of innocent spouse relief *not later than two years after the date the IRS begins collection activities*. IRC § 6015(b)(1)(E).

Failure to prove any one of these conditions will prevent innocent spouse relief. All determinations are to be made without regard to community property laws. See IRC § 6015(a).

Joint Return

Whether a joint return was filed is a question of fact. An innocent spouse must have filed a valid joint income tax return. You should always determine if your client intended to file a joint return and whether he or she actually signed the joint return. If the return is not valid, the innocent spouse is not liable for the tax because he or she never made the election of a joint income tax return. Thus, joint and several liability under IRC § 6013(d)(3) cannot be imposed.

- **Practice Note:** If the requesting spouse can establish that he or she signed a tax return under duress, then the return is not a joint return and relief will be granted based on the fact that there is no joint and several liability.

Understatement

Innocent spouse relief under IRC § 6015(b) requires an understatement of tax attributable to an erroneous item of the other spouse. Generally what this means is that the IRS must have audited the taxpayer and asserted a deficiency. If the client files tax returns and no adjustments were made by the IRS and he/she only owes taxes based on the tax return that was filed, your client is not entitled to relief under IRC § 6015(b).

- **Practice Note:** Math errors under IRC § 6213(g)(2) are generally considered to be “deficiencies” for innocent spouse purposes when determining relief. However, math error adjustments to withholding and estimated tax are not considered deficiency assessments, and therefore, do not qualify for relief under the innocent spouse rules.

Knowledge - Actual Knowledge and/or Reason to Know

The requesting spouse must not have known or must not have had reason to know, of the substantial understatement on the joint return - this condition is the most difficult test to prove to the IRS. The IRS attempts to defeat these claims, if it can be shown that requesting spouse knew or should have known about the unreported income or deductions.

The knowledge condition is satisfied if the requesting spouse did not know, or have reason to have known, when the return was signed that the taxes would not be paid by the other spouse. The requesting spouse must establish that it was reasonable to believe that the other spouse would pay the reported liabilities.

IRM 25.15.3.6.3 states that there are 2 standards that must be considered under this requirement:

- Lack of **actual** knowledge (“did not know”) and
- Lack of **constructive** knowledge (“had no reason to know”)

Actual knowledge is less commonly used by the IRS because it is difficult for the IRS to deny relief on this basis without an admission from the requesting spouse. Therefore, the vast majority of the cases focus on whether the requesting spouse had “reason to know”.

When considering whether a requesting spouse had “reason to know”, the IRS should consider the same factors as considered by the courts. These factors are, but not limited to:

- a) Age of the requesting spouse.

- b) The requesting spouse's educational background and business experience.
- c) Nature of the erroneous item and the amount of the erroneous item relative to other items.
- d) The requesting spouse's degree of control/participation in the household finances.
- e) The extent of the requesting spouse's participation in the activity that resulted in the erroneous item.
- f) Lifestyle during the tax period covered by the understatement, compared with the income reported.
- g) Whether the erroneous item represented a departure from the recurring pattern reflecting in prior years returns.
- h) Whether the requesting spouse failed to inquire, at or before the time the return was filed, but items on the return or admitted from the return that a reasonable person would question.

Partial Relief for Partial Knowledge

Partial relief may be granted when a spouse meets all of the other conditions for innocent spouse, except he or she had knowledge of, or reason to know of, some part of the understatement. IRC § 6015(b) specifically allows partial relief from liability (including penalties, interest, and other amounts) to the extent of the lack of knowledge and reason to know of the understatement. See Treas. Reg. 1.6015-2(e). Therefore, if your client knew about any of the erroneous items (income or deductions) but not the full extent of the items, he or she may be allowed relief for the part of the understatement they did not know about.

Inequitable

Determination whether it is inequitable to hold an innocent spouse liable for the joint tax liability is based on the facts and circumstances of the individual case. See IRC § 6015(b)(1)(D). Relevant factors that the IRS will consider include whether the innocent spouse had been deserted, divorced, was separated from the other spouse, and whether the innocent spouse benefited, directly or indirectly, from an item of omitted income. See Treas. Reg. 1.6015-2(d).

These guidelines should be applied in a consistent and nondiscriminatory manner. Decisions to grant relief should not be based on the subjective personal and/or social beliefs of the IRS employee or any other inappropriate grounds. See IRM 25.15.3.6.4.

Two Year Rule

"Collection activity" begins a two-year statutory limit on filing a claim under either IRC § 6015(b) and (c). The following actions by the IRS constitute collection activity:

- a. IRC § 6330 notice of intent to levy (CDP Notice)
- b. IRC § 6402 offset of an overpayment
- c. A suit filed by the IRS to collect the tax liability
- d. A claim filed by the IRS in a court proceeding in which a taxpayer is a party or in which involved the taxpayer's property (including claims in bankruptcy)
- e. A refund offset to the taxpayers individual or joint account

➤ **Practice Note: IRM 25.15.3.4.4 notes that a CDP notice returned as undeliverable does NOT start the running of the two year statutory period, while a CDP notice that is refused or unclaimed starts the running of the two year statutory period.**

"Collection activity" does not include the following IRS actions:

- Notices of deficiency
- Demands for payment of tax
- Notices of federal tax lien

Innocent Spouse Relief under IRC § 6015(c) - Separate Liability

Procedures are available to limit the liability of taxpayers who are eligible to make a separate liability election. An electing individual's liability for any understatement that is assessed with, respect to a joint return, will not exceed the portion of the deficiency allocated to the electing individual. This election may be made in addition to relief requested under IRC § 6015(b).

Under IRC § 6015(c), your client is eligible to elect this subsection if:

1. A joint return was filed for the year in which relief was requested. See IRC § 6015(c)(1).
2. There is a deficiency of tax attributable to erroneous items of the non-requesting spouse. A spouse may be relieved for a portion of the tax liability arising from a joint item.
3. Marital Status (see IRC § 6015(c)(3)(A)):

- a. At the time election is filed, electing taxpayer is no longer married to, or legally separated from, the individual with whom the taxpayer filed a joint return to which his election relates or
 - b. The electing taxpayer was not a member of the same household as the individual to which the joint return was filed at any time during 12 month period ending on the date election is filed.
4. The spouse claiming relief elects the benefits of innocent spouse relief *not later than two years after the date the IRS begins collection activities*. See IRC § 6015(c)(3)(B)

Mechanics of a IRC § 6015(c) Election

Under the IRC§ 6015(c) election, the separate liability of each spouse is determined by allocating income and deductions as if a separate return was filed (but without considering any of the deductions or credits disallowance that would apply if the joint filers had actually filed separate returns). See IRC § 6015(d).

- **Practice Note:** The practitioner should carefully review any computation by the IRS under IRC § 6015 to ensure that the proper amount of tax is allocated to the client. IRM 25.15.3.7.2.1 explains how to allocate an understatement under IRC § 6015(d). In general, items for which the requesting spouse is granted relief are re-allocated from the joint liability to the non-requesting spouse. Items for which relief is not granted remain part of the couple's joint and several liability.

Members of Same Household

The taxpayers are not members of the same household if they are living apart and are estranged. However, taxpayers are considered “members of the same household” if any of the following conditions are met (see Treas. Reg. § 1.6015-3(b)(3)):

- a. Both spouses reside in the same dwelling.
- b. Both spouses reside in separate dwellings but are not estranged and one of the spouses is *temporarily absent* from the other's household.
 - i. Temporarily Absent. Either spouse is temporarily absent from the household and it is reasonable to assume that the absent spouse will return to the household, and the household or a substantially equivalent household is maintained in anticipation of the absent spouse's return.

- ii. Examples of temporary absences include, but are not limited to, imprisonment, illness, business, vacation, military service, or college.

Knowledge - Actual Knowledge Only

IRM 25.15.3.7.1.1 notes that to deny the election under IRC § 6015(c), the IRS has the burden of proving that the taxpayer had *actual knowledge* of the items giving rise to the deficiency at the time the return was signed. This is a significant difference from the standard for relief under IRC § 6015(b), which places the burden on the taxpayer to establish that he or she did not know and had no reason to know of the understatement. A spouse who is disqualified from innocent spouse relief under IRC § 6015(b) may qualify for relief under IRC § 6015(c) if he or she did not have actual knowledge.

As per Treas. Reg. § 1.6015-3, *actual knowledge* means knowledge of the receipt or expenditure, not the proper tax treatment of the item or whether it was reported on the return. A spouse could have actual knowledge of an item without necessarily knowing its source. If a spouse jointly owns property that is the source of the item, that spouse probably has knowledge of the item.

Your client would have actual knowledge of an erroneous item if:

- They knew that an item of unreported income was received.
- They knew of the fact that they may have incorrect deduction or unallowable credit.
- They knowingly had a false or inflated deduction. They knew that the expense was not incurred or not incurred to the extent shown on the tax return.

Knowledge of the source of the erroneous income is not sufficient to establish actual knowledge. Also actual knowledge may not be inferred by the IRS when you merely had a reason to know of the erroneous item.

Factors Supporting Actual Knowledge

The IRS may rely on all facts and circumstances in determining whether the requesting spouse actually knew of the erroneous items at the time he/she signed the joint return. The following are examples of the fact that the IRS may use in deciding against the requesting spouse:

- Whether the requesting spouse made a deliberate effort to avoid learning about the item(s) in order to be shielded from liability.
- Whether requesting spouse and the non-requesting spouse jointly owned property that resulted in the erroneous item.

Exceptions for Actual Knowledge Rule

Even if the requesting spouse had actual knowledge, he/she may still qualify for relief if it can be established that:

- They were a victim of spousal abuse or domestic violence before signing the return, and
- Because of that abuse they did not challenge the treatment of any items on the return because they were afraid that the spouse or former spouse would retaliate against them.

If it can be established that the joint return was signed under duress (threat of harm or other forms of coercion), then it is not a joint return and the requesting spouse is not liable for any tax shown on that return.

Innocent Spouse Relief under IRC § 6015(f) – Equitable Relief

When an innocent spouse is denied relief or does not qualify for relief under IRC § 6015(b) or IRC § 6015(c), IRC § 6015(f) authorizes the IRS to grant equitable relief if, taking into account the facts and circumstances, it would be inequitable to hold requesting spouse liable for any unpaid tax or deficiency or portion thereof.

Equitable relief is available for **underpayment** of tax and understatement of tax, as well as for penalties and interest.

All the following conditions must be met for an individual to be considered for relief under IRC § 6015(f):

1. The requesting spouse filed a joint return the tax year for which he or she seeks relief.
2. Relief is not available to requesting spouse on the IRC § 6015(b) or (c).
3. The claim for relief is timely filed.
 - a. If the requesting spouse is applying for relief from a liability or a portion of a liability that remains unpaid, the request for relief must be made before the Collection Statute Expiration Date (CSED), of

the income tax liability, as provided in IRC § 6502. Generally, the CSED is ten years after the assessment of tax.

- b. Claims for credit or refund of amounts paid, must be made before the expiration of the period of limitation on credit or refund provided in IRC § 6511. Generally, that period expires three years from the time the return was filed or two years from the time the tax was paid, whichever is later.
- 4. No assets are transferred between the spouses as part of a fraudulent scheme by the spouses.
 - 5. The non-requesting spouse did not transfer disqualified assets to the requesting spouse.
 - 6. The requesting spouse did not file, or fail to file, the return with fraudulent intent.
 - 7. The tax liability is attributable to an item of the non-requesting spouse, unless one of the following exceptions applies:
 - a. Attributions Solely to the Operation of Community Property Law. If an item is attributable or partially attributable to the requesting spouse solely due to the operation of community property law, then for purpose of determining innocent spouse relief, that item (or portions thereof) will be considered to be attributable to non-requesting spouse.
 - b. Nominal Ownership. If the item is titled in the name of requesting spouse, the item is presumably attributable to the requesting spouse. This presumption is rebuttable.
 - c. Misappropriation of Funds. If the requesting spouse did not know, and had no reason to know, that funds intended for the payment of tax were misappropriated by the non-requesting spouse for the non-requesting spouses benefit, the IRS will consider granting equitable relief, although the underpayment may be attributable in part or in full to an item of the requesting spouse. The IRS will consider relief in this case only to the extent that the funds intended for payment of tax were taken by the non-requesting spouse.
 - d. Abuse Not Amounting to Duress. The requesting spouse establishes that he or she was the victim of abuse prior to the time the return was signed, and so did not challenge the treatment of

any item on the return for fear of the non-requesting spouses retaliation, the IRS will consider granting equitable relief although the deficiency or underpayment may be attributable in part, or in full, to an item of the requesting spouse.

- e. Fraud Committed by Non-Requesting Spouse. If the requesting spouse establishes that the non-requesting spouse's fraud is the reason for the erroneous item, the Service will consider granting equitable relief although the deficiency or underpayment may be attributable in part or in full to an item of the requesting spouse.

The requesting spouse, satisfying all of the applicable conditions set forth above, may be relieved of all or part of their liability under IRC § 6015(f), if taken into account all the facts and circumstances, the IRS determines that it would be inequitable to hold the requesting spouse liable for such liability.

Equitable Relief Factors - Rev. Proc. 2013-34

While Rev. Proc. 2013-34 generally follows the structure and format of Rev. Proc. 2003-61, it includes some significant changes. Rev. Proc. 2013-34 gives greater weight to the presence of abuse when its presence affects the analysis of other factors. The guidance provides that under the timeliness threshold condition, a request for equitable relief must be filed before the expiration of the period of limitation for collection under IRC § 6502 or the expiration of the period of limitation for credit or refund under IRC § 6511, whichever is applicable. The attribution threshold condition adds a new exception to the requirement that the income tax liability be attributable to an item of the non-requesting spouse. Under the guidance, relief would not be precluded for an item attributable to the requesting spouse if the non-requesting spouse's fraud gave rise to the understatement of tax or deficiency.

Streamlined determinations of equitable relief under IRC § 6015(f) now apply to understatements of income tax instead of only underpayments. If a requesting spouse isn't entitled to a streamlined determination the requesting spouse may be considered for relief under equitable factors, many of which have been clarified under Rev. Proc. 2013-34.

Streamlined Determination

If a requesting spouse satisfies the following threshold conditions, Rev. Proc. 2013-34 authorizes the IRS to consider whether the requesting spouse is entitled to a so-called "streamlined determination" of equitable relief under IRC § 6015(f):

- a. The requesting spouse is no longer married to, is legally separated from, or has lived apart for more than 12 months from the nonrequesting spouse.
- b. The requesting spouse would suffer economic hardship if relief were not granted.
- c. The requesting spouse did not know, or have reason to know, that there was an understatement or underpayment of tax on the joint tax return. However, if the non-requesting spouse abused the requesting spouse or maintained control over the household finances by restricting the requesting spouse's access to financial information and the requesting spouse was not able to challenge the treatment of any item or question the payment of taxes for fear of retaliation, the abuse or financial control will result in this factor being satisfied, even if the requesting spouse had knowledge or reason to know of the items giving rise to the understatement or deficiency or that the non-requesting spouse would not pay the tax liability.

Non-Streamlined Determination

If the requesting spouse does not qualify for streamlined determination, the IRS will use the following nonexclusive list of factors to determine if relief will be granted. No single factor will be determinative. Rather, the IRS will consider and weigh all relevant factors, regardless of whether the factor is listed in Rev. Proc. 2013-34.

- *Marital Status.* Whether the requesting spouses is separated (whether legally separated or living apart) or divorcing from the non-requesting spouse. A temporary absence, such as absence due to incarceration, illness, business, vacation, military service, or education, shall not be considered a separation if it can be reasonably expected that the absent spouse will return to the household. Reg. 1.6015-3(b)(3) gives a definition of a temporary absence.
- *Economic Hardship.* Whether the requesting spouse will suffer economic hardship (even if such hardship does not constitute *undue hardship* within the meaning of Treas. Reg. § 301.6343-1(b)(4)) if the service does not grant relief from the income tax liability.
- *Knowledge or Reason to Know.*
 - *Underpayment Cases.* In the case of an income tax liability that was reported but not paid, where the requesting spouse did not know and had no reason to know that the non-requesting spouse would not pay the income tax liability.

- *Deficiency Cases.* In the case of income tax liability that rose from a deficiency, where the requesting spouse did not know and had no reason to know, of the items giving rise to deficiency. Reason to know of the items giving rise to deficiency will not be weighed more heavily than other factors. Actual knowledge of the items giving rise to deficiency, however, is a strong factor weighed against relief. This disadvantage may be overcome if the factors in favor of equitable relief are particularly compelling.
 - *Reason to Know.* For purposes of the first two items, determining whether the requesting spouse had reason to know, the IRS will consider the requesting spouse and level of education, any deceit or evasiveness of the non-requesting spouse, requesting spouse's degree of involvement in the activity that generated the income tax liability, requesting spouse's involvement in business and household financial matters, requesting spouse's business or financial expertise, and any lavish unusual expenses compared to past spending.
- *Non-Requesting Spouse's Legal Obligation.* Whether the non-requesting spouse has a legal obligation to pay the outstanding income tax liability pursuant to a divorce decree or arrangement. This fact will not weigh in favor of relief if the requesting spouse knew or had reason to know, when entering into the decree or arrangement, that the non-requesting spouse would not pay the tax.
- *Significant Benefit.* Whether requesting spouse received significant benefit (beyond normal support) from the unpaid income tax liability or item giving rise to deficiency. See Treas. Reg. 1.6015-2(b).
- *Compliance with Income Tax Laws.* Whether requesting spouse has made a good faith effort to comply with the tax laws in the year(s) following the years to which the request for relief relates.
- *Abuse.* If the requesting spouse establishes that he or she was the victim of abuse (not amounting to duress), the abuse may result in certain factors weighing in favor of relief when otherwise the factor may have weighed against relief. 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 undermine the requesting spouse's ability to reason independently and do what is required under the tax laws. Depending on the facts and circumstances, abuse of the requesting spouse's child or other family member living in the household may constitute abuse of the requesting spouse. See Treas. Reg. § 1.6015-1(b).

- *Mental or Physical Health.* Whether the requesting spouse was in poor mental or physical health on the date he or she signed the return. The IRS will consider the nature, extent, and duration of illness when weighing this factor.

Claims for Refund under the Innocent Spouse Provisions

Refunds under IRC § 6015(b) and (c)

If a taxpayer is granted innocent spouse relief under the IRC § 6015(b) general rule, refunds are permitted with limitations. See IRC Sec. 6015(g)(1). However, refunds are not permitted if relief is granted under the IRC § 6015(c) separate liability election rules. See IRC Sec. 6015(g)(3).

Refunds under IRC § 6015(f)

In both understatement and underpayment cases, a requesting spouse is eligible for a refund of separate payments if the requesting spouse establishes that he or she provided the funds used for the payments. See IRS Notice 2012-8 and Rev. Proc. 2013-34.

A requesting spouse is not eligible for a refund of payments made with the joint return, joint payments, or payments that the non-requesting spouse made. A requesting spouse may be eligible for a refund of his or her portion of the requesting and non-requesting spouse's joint overpayment from another tax year that was applied to the joint income tax liability to the extent that the requesting spouse establishes that he or she provided the funds for the overpayment.

Limitations of Refunds

If the innocent spouse files for relief within three years of filing the tax return, the innocent spouse can receive a refund of the part of the tax that was paid within the past three years (plus any extension of time for filing). If the innocent spouse files for relief after the expiration of the three-year period but within two years from the time the innocent spouse paid the tax, the innocent spouse can receive a refund of the tax paid within the two years immediately before relief was requested.

Collection Actions

IRC § 6015(e)(1)(B) generally prohibits levies and judicial proceedings while an innocent spouse claim is pending. Refund offsets are not prohibited by statute. However, the IRS has made a policy decision not to offset refunds while a claim is pending.

- **Practice Note:** If a prohibited collection action or a refund offset has occurred in violation of the statute or the policy, the IRS must take

corrective measures to refund the money to the requesting spouse. See IRM 25.15.3.4.5.

Suspension of Statute of Limitations

Since the IRS is prohibited from taking collection action while the request for relief is pending, the running of the statute of limitations for collection is suspended for the period of time the IRS was prohibited from taking collection action plus 60 days thereafter.

Effects of Bankruptcy

Rev. Rul. 2006-16 addressed the issue of whether a requesting spouse was precluded from raising a request for relief from joint and several liability under IRC § 6015 by virtue of a previous Chapter 7 bankruptcy case. The ruling held that the taxpayer was not precluded from raising a subsequent request for relief from joint and several liability under IRC § 6015 where the IRS filed a proof of claim but the bankruptcy court did not make an actual determination of the liability.

Substitute for Return (SFR)

A taxpayer's filing status on a SFR will be either single or married filing separately. The Service cannot elect joint filing status for married taxpayers; thus, there will not be a joint liability, and there can be no relief under IRC § 6015 from a liability due to an SFR. The taxpayer may later file a joint return with his/her spouse. It is not until this joint return is filed that relief under IRC § 6015 can even be considered. The important thing to remember when determining whether relief under IRC § 6015(b), IRC § 6015(c), or IRC § 6015(f) is available, is the type of liability (underpayment versus understatement) generated by the joint return.

If the Service filed an SFR for a nonfiler spouse (and took no action against the other spouse) and the spouses later file a joint tax return before the issuance of a Statutory Notice of Deficiency, this joint return should be considered the spouse's original return for purposes of relief under IRC § 6015. If the joint return properly reported all income but was not accompanied by full payment of the tax liability, the liability is an underpayment (self-assessed tax). Thus, if either the nonfiler spouse or the other spouse requests relief under IRC § 6015 for this joint liability, only relief under IRC § 6015(f) can be considered. If the joint return underreports income, and the Service determined a deficiency, then IRC § 6015(b), IRC § 6015(c), and IRC § 6015(f) can be considered for either spouse for the portion that is a deficiency.

If the Service filed an SFR for a nonfiler spouse (and took no action against the other spouse) and an assessment was made following a Statutory Notice of Deficiency, the resulting amount owed by the nonfiler spouse is a liability due to a deficiency assessment. However, because no joint election was made, the taxpayer's liability is not eligible for relief under IRC § 6015. If the nonfiler spouse

and the other spouse later file a joint return that properly reported all income but was not accompanied by full payment of the tax liability, the liability should be considered an underpayment. Thus, if either the nonfiler spouse or the other spouse requests relief under IRC § 6015 for this joint liability, only relief under IRC § 6015(f) can be considered. If the joint return underreports income, and the Service determines a deficiency, then IRC § 6015(b), IRC § 6015(c), and IRC § 6015(f) can be considered for either spouse for the portion that is a deficiency.

If the Service filed an SFR for a nonfiler, the taxpayer may file a joint return in response. In some circumstances the service will process the return but keep the exam open because there are items still under review. See IRM 4.19.17.7.2.2, *Agreed – Partially Accepted*. In this circumstance the taxpayer and the taxpayer's spouse may sign an examination report or similar waiver agreeing to the tax prior to the issuance of a Statutory Notice of Deficiency. If this occurs, the tax liability is considered an understatement. This is because signing a report or waiver is not the equivalent of signing and filing a joint return.

Offer in Compromise (OIC)

A taxpayer may file an OIC to compromise his or her outstanding tax liability for a lesser amount where the taxpayer's assets and income are insufficient to pay the full amount, where there is doubt as to the taxpayer's liability, or where due to exceptional circumstances, requiring full payment of the tax would cause an economic hardship or be unfair and inequitable.

An accepted OIC conclusively settles the taxpayer's liability specified in the offer. See Treas. Reg. § 301.7122-1(e)(5). Once an OIC is accepted, the taxpayer may not contest the amount of the liability. Therefore, a taxpayer with an accepted OIC cannot file a claim for innocent relief from any liability covered by the OIC. This is true even if the taxpayer later defaults on the accepted OIC.

If a spouse requesting relief from joint and several liability was **not** a party to the other spouse's accepted OIC, then that spouse may file a claim for relief from liability.

If there is a pending OIC, you can advise the taxpayer of the consequences if the OIC is accepted. For example, the acceptance of an OIC precludes the taxpayer from subsequently being considered for relief from joint and several liability for the same tax period.

If relief from joint and several liability is the only issue present in an OIC (i.e., the taxpayer submits a doubt as to the liability offer), you might want to suggest the taxpayer withdraw the offer and file Form 8857, *Request for Innocent Spouse Relief*. If relief is not granted through the innocent spouse provisions, the taxpayer may submit another OIC.

Return Signed Under Duress

If a spouse claims he or she signed the joint tax return under duress or was coerced into signing it, the election to file a joint return may be invalid. In that case, the issue of relief from joint and several liability is not applicable.

To establish a return was signed under duress, the taxpayer must demonstrate:

- a. The taxpayer was unable to resist demands to sign the return; and
- b. The taxpayer would not have signed the return except for the constraint applied by the other party. See. *Stanley v. Commissioner*, 45 T.C. 555 (1966); *Brown v. Commissioner*, 51 T.C. 116 (1968).
- c. A signature made involuntarily or under duress is not a valid signature. Therefore, the election to file a joint return is not valid.
- d. The individual claiming duress is not jointly or severally liable for liabilities arising from such a return if the return was indeed signed under duress.
- e. The account should be adjusted to reflect a married filing separate return being filed by both spouses.
- f. A married filing separate tax return may need to be secured from the spouse claiming to have signed under duress if a return is required for the period or if the taxpayer may have been entitled to a refund.

➤ **Practice Note:** There are certain credits not available when spouses file separate returns.

- g. A requesting spouse (RS) who raises the issue of duress and later determines he or she would owe more tax if he or she filed separately, may choose not to pursue the issue of duress.

➤ **Practice Note:** Line 12 of the Form 8857 asks the requesting spouse whether the return was signed under duress.

- h. The determination of whether or not an income tax return was jointly filed presents a question of fact. The resolution of the factual issue should focus on the intention of the parties or taxpayers for the return in question. For a discussion of the factors to consider when making the determination, see *United States v. Kramer*, 83-2 USTC (CCH) P9474 (D. Md.1983) and the cases cited therein.

Forged Signatures

When a spouse establishes his or her signature on a joint return was forged and there was no tacit (implied) consent to the return as filed, the joint election is invalid. Again, the relief from joint and several liability provisions do not apply. See IRM 25.15.7.10.13.5.1, *Tacit Consent Factors*.

The individual claiming his or her signature was forged is not jointly or severally liable for liabilities arising from such a return if the signature was indeed forged.

- **Practice Note:** Line 12 of the Form 8857 asks the RS whether the signature was forged.
- **Practice Note:** The IRS may require that a “MFS” tax return may need to be secured from the spouse claiming forgery if a return is required for the period or if the taxpayer may have been entitled to a refund.
- **Practice Note:** There are certain credits not available when spouses file separate returns.
- **Practice Note:** The IRS may consider referring the individual who forged the signature and any other individual associated with the forgery to the Criminal Investigation Division.

Steps in Handling an Innocent Spouse Case

Step 1 - Determine Whether Relief Is Available

The first step in any innocent spouse case is to make a preliminary determination that innocent spouse is the appropriate resolution for your client's tax case.

- Address conflict of interest concerns.
- Determine the current marital status of the spouses.
- Determine whether a joint return was filed. This requires review of the client's filing history and an analysis of whether joint filing was under duress, by fraud, or otherwise not freely made.
- Verify that there is an understatement of tax.
- Determine whether each understatement is due to the non-requesting spouse.
- Determine whether requesting spouse that actual knowledge of the understatement.
- Investigate whether the requesting spouse should have known of the understatement.
- Determine whether it has been more than two years since the IRS started collection activity against the innocent spouse. The request for innocent spouse relief must be filed within two years from the first collection activity, unless they qualify for relief under IRC § 6015(f).

Step 2 - - Develop the Evidence

The next step to a successful resolution of your client's case is to develop evidence to support the innocent spouse status.

- Obtain a personal history of the requesting spouse, including education, business experience, financial skills, involvement in family finances, familiarity with the non-requesting spouse's business, awareness of family finances, and how family finances were handled.
- Determine who gathered the information for the tax filings, who participated in preparing the tax returns, who discussed the tax

information with the tax preparer (if any), and what review, if any, was made before the returns were filed.

- If there was no review of the return, determine why not.
- Determine whether the client asked questions about the tax return. If so, did the client receive untruthful or evasive answers? If so, this may satisfy the innocent spouse's duty to inquire.
- Develop evidence that it is unfair to hold the requesting spouse liable for the tax.
 - Review legal agreements (separation agreement, divorce decree, property settlement, etc.) to determine whether the parties agreed between them who should pay the tax liability.
 - Determine if there was physical or mental abuse, or the non-requesting spouse deceived the requesting spouse about the erroneous items.
 - Develop evidence of manipulation of the requesting spouse.
 - Develop evidence that, given the requesting spouse's economic situation, the payment of the tax would create a hardship.
 - Determine whether there were expenditures made to support or maintain third parties or whether there were specific activities (gambling, etc.) that the requesting spouse was unaware of or could not control.
- Obtain evidence that the requesting spouse realized no significant benefit from the erroneous items (unreported income or improper deductions).
 - Determine whether the requesting spouse received gifts from the nonrequesting spouse.
 - Determine whether the family enjoyed a standard of living higher than the reported income would have indicated.
 - Determine whether there were any lavish or unusual purchases or expenditures, or a substantial accumulation of joint assets.
 - Determine whether the nonrequesting spouse maintained separate assets or bank accounts.
 - Determine whether there were expenditures made for third parties and whether the requesting spouse was aware of the expenditures.

- Determine whether the requesting spouse or non-requesting spouse had any vices (gambling, philandering, drugs, etc.).
- Obtain a list of potential witnesses to support the requesting spouse's case.
 - Consider obtaining an affidavit from each witness concerning that witness' knowledge.
 - Probe for facts both favorable and unfavorable to the requesting spouse's case, so that all facts can be addressed and developed prior to presentation to the IRS.

Step 3 - Application for Innocent Spouse Status

Application for innocent spouse relief is made by filing Form 8857. You should file form 8857 as soon as you become aware that your client may be eligible for innocent spouse relief. If your client is under examination, in appeals, or in collections, Form 8857 should be filed with the Revenue Agent, Revenue Officer, or Appeal Officer involved in the case.

- **Practice Note:** If your client has received a Notice of Deficiency (90-day letter), but the 90 day period has not lapsed, Form 8857 should be filed with the IRS employee named in a Notice of Deficiency. A Tax Court petition must still be filed if the matter is not resolved within the 90 days. An affirmative defense of innocent spouse relief must be specifically alleged in the petition.

Step 4 – Present Your Case

The forum for presenting the case will depend upon where the client is in the procedural process when the innocent spouse issue arises. If the client is under audit, the practitioner can begin with a face-to-face presentation of the facts that support the request. Even though this can be done in person, Form 8857 should be prepared and filed with the examiner to formally begin the process. If the client is already in collection, the process begins with the filing of the Form 8857. Thereafter, the practitioner will likely obtain a face-to-face opportunity to present the facts only if the initial request is denied and the client decides to appeal the denial.

- **Practice Note:** Whether to bring the requesting spouse is a professional judgment that must be carefully considered on a case by case basis. Most practitioners agree that the requesting spouse should not appear at the meeting unless credibility is important and the requesting spouse would persuade the examiner that relief is appropriate.

Former Spouse

By law, the IRS must contact your client's spouse or former spouse. There are no exceptions even for victims of spousal abuse or domestic violence.

The IRS will inform your client's spouse or former spouse that they file Form 8857 and allowed him/her to participate in the process. If the request for relief is from joint and several liability on a joint return, the IRS must inform him/her of its preliminary and final determinations regarding their request for relief.

However to protect your client's privacy, the IRS will not disclose your client's personal information (for example current name, address, phone number, information about employer, income or assets) for any other information that relates to make a determination about the release or requests from liability.

- **Practice Note:** If your client has been a victim of domestic violence and fears that filing a claim for innocent spouse relief will result in retaliation, you should write "Potential Domestic Abuse Case" at the top of Form 8857. You should explain his or her concerns in a statement attached to the claim, in addition to explaining why he or she qualifies for innocent spouse relief.
- **CAUTION:** If you petition the Tax Court your client's spouse or former spouse may see his/her personal information.

Step 5 - Appealing an Adverse Decision

If the IRS examiner determines that spousal relief should not apply to your client, you should consider appealing the decision. One of the most important considerations in an appeal of innocent spouse cases, is the question of whether it's equitable to provide relief. Since is a very subjective "condition", you may find the appeal officer to have a more sympathetic attitude than the examination officer.

Step 6 - Petitioning the Tax Court

If Appeals denies your client relief under the innocent spouse rules, consider filing a Tax Court petition. The Tax Court has ruled that establishing equitable relief will be on the basis of the court record and not the administrative record.

After you file Form 8857, you may be able to petition the Tax Court to review your request for relief in the following two situations:

1. The IRS sends your client a final determination letter denying his/her request for relief.
2. Your client does not receive a final determination letter from the IRS within six months from the date he/she filed Form 8857.

You must file a petition with the Tax Court in order for it to review the denial for innocent spouse relief. You must file a petition ***no later than 90 days*** after the date the IRS mails its final determination notice to your client. If a petition is not filed or is filed late, the Tax Court cannot review your request for relief.

A Tax Court petition can be filed under the small case procedure authorized by IRC § 7463(f)(1), which is available when “the amount of relief sought does not exceed \$50,000.”

You can download a copy of the rules of filing a petition in the Tax Court by visiting the Tax Court's website at www.ustaxcourt.gov.