

INNOCENT SPOUSE RELIEF

PRIMER

Overview

When spouses file a joint income tax return, they are jointly and severally responsible for the entire tax liability,¹ but a spouse may request relief for all or a portion of the liability in certain circumstances of unfairness pursuant to § 6015 of the Internal Revenue Code ("IRC") and its associated regulation, Treas. Reg. 1.6015.

§ 6015 is commonly called the "innocent spouse relief" provision, but this section actually describes three types of relief:

- innocent spouse relief;
- allocation of deficiency, more commonly called separation of liability; and
- equitable relief.

Innocent spouse relief generally relieves a spouse of all

responsibility for the joint tax liability at issue.

Separation of liability, on the other hand, allocates the tax liability between spouses, as if they had filed separate tax returns, usually. Equitable relief can relieve a spouse of some or all responsibility for joint tax liability, but only if the unfairness of the situation cannot be remedied by innocent spouse relief and separation of liability.

There is another type of spousal tax relief available for non-joint filers. In community property states,² spouses may face liability for tax attributable to items of community income even though they file separate tax returns. In that situation, a spouse may request relief for all or a portion of the liability, again in certain circumstances of unfairness, pursuant to IRC §

66(c). The two types of relief available under § 66(c) and Treas. Reg. 1.66-4 are:

- traditional relief from community income tax; and
- equitable relief.

Traditional § 66(c) relief shifts all responsibility for tax attributable to the item of community income at issue away from the requesting spouse. Equitable relief, which is only available if traditional relief is not, can also do the same.

The Legal Tests

Innocent Spouse Relief

A requesting spouse may receive innocent spouse relief pursuant to § 6015(b) and Treas. Reg. 1.6015-2 if:

- they filed a joint return;
- the joint return contains a tax understatement due to erroneous items (e.g., unreported income or incorrectly claimed deductions, credits, or property bases) of the nonrequesting spouse with whom the requesting spouse filed the return;
- in signing the return, the requesting spouse did not know and had no reason to know that there was such understatement; and
- in all the facts and circumstances, holding the requesting spouse liable for the tax understatement would be unfair.

Separation of Liability

A requesting spouse may receive separation of liability or allocation of deficiency pursuant to § 6015(c) and Treas. Reg. 1.6015-3 if:

- they filed a joint return;
- the joint return contains an understatement of tax that was not due to tax-avoiding transfers or a fraudulent scheme of the spouses;
- at the time of signing the return, the requesting spouse did not have actual knowledge of the understatement, unless the return was signed

under duress; and

- at the time of requesting relief, the spouses who filed the joint return are no longer married, legally separated, or were not members of the same household in the preceding 12-month period.³

Equitable Relief Under § 6015

A requesting spouse may receive equitable relief pursuant to § 6015(f) and Treas. Reg. 1.6015-4 if:

- they filed a joint return;
- relief is not available under either §§ 6015(b) or (c);
- the joint return contains an understatement of tax, or the stated tax was underpaid, and they were not due to tax-avoiding transfers or fraudulent schemes of the spouses; and
- taking into account all the facts and circumstances, holding the individual liable for any unpaid tax or deficiency would be unfair.

Traditional § 66(c) Relief

A requesting spouse may receive traditional § 66(c) relief pursuant to that subsection and Treas. Reg. 1.66-4 if:

- they did not file a joint return;
- they did not include the item of community income in gross income;
- the item of community income is derived, generally, from the nonrequesting spouse's employment, business, partnership or separate property;
- the requesting spouse did not know, and had no reason to know, of the item of community income; and
- taking into account all of the facts and circumstances, including the item of community income in the requesting spouse's individual gross income would be unfair.

Equitable Relief Under § 66(c)

A requesting spouse may receive equitable relief pursuant to § 66(c) and Treas. Reg. 1.66-4 if:

- the requirements for traditional § 66(c) relief are not satisfied, but
- holding the requesting spouse liable for the unpaid tax or deficiency arising from the operation of community property law would still be unfair.

Time Limits for Requesting Relief

All of these types of relief also require an election or request from the requesting spouse within the relevant time limits. For all relief other than equitable relief under § 6015(f) or § 66(c), the time limit for making the election is generally 2 years after the IRS commences collection activities. In the case of equitable relief, the time limit may be longer, depending on whether a credit or refund is being sought versus relief from a balance due.⁴

Key Concepts

Knowledge and Reason to Know (Actual Knowledge and Constructive Knowledge)

Innocent spouse relief under § 6015(b) and traditional § 66(c) relief are unavailable in the face of the requesting spouse's knowing (actual knowledge) or having reason to know (constructive knowledge) that there was an understatement of tax on the relevant tax return. Separation of liability may be available if the requesting spouse had reason to know of such understatement, as long as there was no actual knowledge. For equitable relief, actual or constructive knowledge that a return contains a tax understatement or that the tax owing would be unpaid or underpaid is not an automatic bar to relief, but it is still considered as part of the fairness analysis.

Actual knowledge can be established by knowledge of the transaction giving rise to the tax deficiency, regardless of whether the requesting spouse understood the tax consequences of that transaction. For example, knowing that: (i) an item of unreported income was received; (ii) an incorrect

deduction or credit was unallowable; or (iii) an expense was not incurred or not incurred to the extent reported on the tax return can constitute actual knowledge, even if a person did not know the exact amount of the resulting tax deficiency. Actual knowledge, however, is not established by knowledge of the source of an erroneous item alone, such as if a person is simply aware that their spouse works for a certain employer and nothing else.⁵

Constructive knowledge, or reason to know, can be established if a reasonable person in similar circumstances would have known about the transaction giving rise to the tax deficiency, pursuant to Treas. Reg. 1.6015-2 and 1.6015-3.

In determining whether reasonable person in similar circumstances would have known, all of the facts and circumstances will be considered, including, but not limited to:

- the nature of the erroneous item and its amount relative to other items;
- the couple's financial situation;
- the requesting spouse's educational background and business experience;
- the extent to which the requesting spouse participated in the activity resulting in the erroneous item;
- whether the requesting spouse failed to inquire about items included on or omitted from the return that a reasonable person would have questioned; and
- whether the erroneous item represented a departure from a recurring pattern reflected in prior years' returns.⁶

Part of the reason-to-know analysis involves determining whether the requesting spouse, regardless of level of education or involvement in family finances, asked appropriate questions about the tax return before signing. In circumstances where a reasonable person would at least have asked

questions about the propriety of the tax situation, the requesting spouse has a duty of inquiry. Another way of putting it would be that a requesting spouse may not have reason to know of an actual deficiency, but still have reason to know of a possible deficiency that puts him or her on notice that something might be amiss. In that situation, failing to make inquiries can lead to constructive knowledge being imputed to the requesting spouse.⁷

Fairness

Another facts-and-circumstances analysis is required to determine whether it is fair to grant or deny innocent spouse relief, traditional § 66(c) relief, or equitable relief under either § 6015 or § 66(c). Separation of liability, however, does not require a separate fairness determination.

While not providing an exhaustive list, Treas. Reg. 1.6015-2(d) specifically points out three factors as being relevant to the determination of fairness:

- whether the requesting spouse obtained a significant benefit, defined as any benefit in excess of normal support, directly or indirectly, from the tax deficiency;
- whether the requesting spouse has been deserted by the nonrequesting spouse; and
- whether the requesting and nonrequesting spouse have been divorced or are separated.

The case law indicates that the factors cited and considered most often in the fairness analysis are whether the requesting spouse received a significant benefit from the tax liability and what concealment, overreaching or other wrongdoing was committed by the nonrequesting spouse.⁸ Knowledge of erroneous items on a joint income tax return is also of special importance,⁹ as is whether the requesting spouse would suffer economic hardship, defined as the inability to pay reasonable basic living expenses, if held liable for the tax owed.¹⁰

Rev. Proc. 2013-34 contains the IRS' current

guidance on the fairness determination in spousal tax relief. While this guidance is not binding on the court, many court decisions do refer to the factors enumerated and make decisions consistent with it. The factors listed at Rev. Proc. 2013-34 include: the marital status of the spouses;

- whether the requesting spouse would suffer economic hardship if relief were not granted;
- whether the requesting spouse had actual knowledge or reason to know;
- whether the requesting spouse was the victim of abuse;
- whether either spouse had a legal obligation to pay the outstanding Federal income tax liability;
- whether the requesting spouse obtained a significant benefit from the unpaid income tax liability or understatement;
- compliance with income tax laws in subsequent years; and
- the mental or physical health of the requesting spouse.

Concepts in Action: Case Law Examples

Reason to Know

In *Price v. Commissioner*, 887 F.2d 959, 965 (9th Cir. 1989), analysis of the relevant factors going to constructive knowledge indicated that the requesting spouse did not have reason to know, and she satisfied her duty of inquiry. She did not have formal financial education or training. She had limited involvement in family financial affairs and no involvement with the specific investment giving rise to the tax deficiency. The nonrequesting spouse used a separate checking account for his investments and had misled her. There were no unusually lavish expenditures made around the time of the tax return that might have alerted the requesting spouse and triggered her duty of inquiry, but she was put on notice by the large size of the deduction claimed in relation to the total income.

requesting spouse and triggered her duty of inquiry, but she was put on notice by the large size of the deduction claimed in relation to the total income. She did fulfill her duty of inquiry by asking the nonrequesting spouse about it, and she only signed the tax return after receiving the assurance that it had been approved by a reputable CPA. It was reasonable for her to believe that assurance, given her relative lack of experience and understanding of financial affairs.

In contrast, in *Greer v. Commissioner*, 595 F.3d 338 (6th Cir. 2010), while the requesting spouse had no formal financial training and only limited involvement in the family's finances, and thus did not have reason to know of an actual tax deficiency, it was held that she ought to have been put on notice by the low level of taxes owed relative to income reported as well as the amount of refunds claimed for previous tax years. She did not fulfill her consequent duty of inquiry because she did not make any inquiries at all, and there was no evidence that she was frustrated or prevented in this by the nonrequesting spouse's deceit or abuse.

Fairness

In *Campbell v. Commissioner*, 91 T.C.M. 735 (2006), not only did the requesting spouse not receive any significant benefit from the tax deficiency, as a result of the nonrequesting spouse's evasive and secretive conduct, she actually lost access to \$2.6 million in her account, never saw the money again, and the family's lifestyle significantly declined thereafter. Her financial circumstances at the time of the hearing were such that she would suffer severe economic hardship if she had to face the tax liability resulting from the nonrequesting spouse's activities, of which she had no knowledge or reason to know, far less control over. She received innocent spouse relief under § 6015(b).

Karam v. Commissioner (T.C. Memo 2011-230), on the other hand, while not involving deceit or

abuse by the nonrequesting spouse, did involve circumstances where the requesting spouse was able to obtain her Ph.D. and send each of her four children to expensive private schools as a consequence of the savings arising from underpayment of tax. There was no evidence that she would suffer economic hardship if she had to pay the tax liability. It was also significant that the requesting spouse had reason to know that the nonrequesting spouse would not pay the tax liabilities at issue. It was fair to deny her equitable relief under § 6015(f).

The requesting spouse in *Rogers v. Commissioner*, T.C. Memo. 2020-91 also did not suffer deceit or abuse by the nonrequesting spouse. She could not show economic hardship from having to pay the tax liability. Although she did not personally receive a significant benefit from the tax deficiencies, she had provided significant funds to her adult son and this was enough to tip this factor towards denial of relief. The court paid special attention to the fact that she knew about the tax deficiencies in holding that fairness did not permit her to receive § 6015(f) equitable relief just because her blind devotion to her husband made her willing to set aside her intellect to support him in his improper tax schemes.

In contrast to *Campbell*, *Karam*, and *Rogers*, the requesting spouse in *Jacobsen v. Commissioner*, 950 F.3d 414 (7th Cir. 2020) did not obtain a significant benefit. He also did not show economic hardship or that he was a victim of abuse or deceit with respect to the specific tax liability at issue. He did, however, have actual knowledge of the tax understatement, which had arisen from the nonrequesting spouse's criminal embezzlement activities, and had gone ahead with filing an improper tax return despite that knowledge. The Court of Appeals stated that this was a close case, but that the Tax Court had not been wrong in denying § 6015(f) equitable relief in such circumstances.

Roadmap

The following may be a useful guide for considering eligibility for spousal tax relief under either § 6015 or § 66(c):

1. Nature of tax return and tax deficiency.

i. **Type of tax return filed.** § 6015 only potentially provides relief from joint and several tax liability arising from a joint tax return. § 66(c) only potentially provides relief from a tax liability arising from an omitted item of community income in a non-joint return.

ii. **Duress, forgery, fraud, or tax avoidance with respect to joint tax return.** Neither a joint tax return signed under duress nor a joint tax return with a forged signature is a valid tax return. Generally, the remedy for an invalid joint tax return is an adjustment to reflect a married filing separate return,¹¹ and § 6015 relief would not apply. Spousal tax relief is also not available in situations where spouses transfer assets to one another as part of a fraudulent scheme or for the main purpose of avoiding tax.¹²

iii. Understatement or underpayment of tax.

An understatement occurs when an item of income that should have been reported on a tax return is not so reported, such that the tax liability shown on the tax return is understated. An underpayment occurs when the tax liability on the tax return is correct, but it is not paid or underpaid. If the tax liability arises from an underpayment of tax, the only type of relief potentially available is equitable relief under § 6015(f) or § 66(c)(4).

iv. **In the case of an understatement, attribution of erroneous item.** If an understatement of tax arises from items that are attributable to, or owned by, both the

requesting spouse and the nonrequesting spouse, as opposed to solely the nonrequesting spouse, then neither innocent spouse relief under § 6015(a) nor traditional community relief under § 66(c) are available.

2. **Level of knowledge.** Actual knowledge of a tax understatement or underpayment bars all types of relief except equitable relief under § 6015(f) or § 66(c)(4). A requesting spouse who only had reason to know, but not actual knowledge, of a tax understatement on a joint return may be eligible for separation of liability under § 6015(c) before having to consider equitable relief under § 6015(f).

3. **Fairness of granting or denying relief.** An all-facts-and-circumstances analysis can include, but is not limited to, consideration of the factors discussed at Rev. Proc. 2013-34. While the following guidance is not binding on the court, it is still instructive.

i. **Marital status.** Being divorced or separated from the nonrequesting spouse or widowed at the time of determination favors relief. Being still married is neutral.

ii. **Economic hardship.** Being unable to pay reasonable basic living expenses if held liable for the tax deficiency favors relief. Lack of economic hardship is neutral.

iii. **Knowledge** - Not having actual or constructive knowledge that the tax was understated or would be unpaid or underpaid favors relief. Having actual or constructive knowledge weighs against relief, unless the requesting spouse's lack of action around that knowledge was due to being abused by the nonrequesting spouse.

iv. **Significant benefit.** Receiving an economic benefit beyond normal support weighs against relief, unless it was in circumstances of abuse

by the nonrequesting spouse, including physical, psychological, sexual, or emotional abuse such as efforts to control, isolate, humiliate, and intimidate the requesting spouse favors relief.

v. **Abuse.** Being the victim of abuse by the nonrequesting spouse, including physical, psychological, sexual, or emotional abuse such as efforts to control, isolate, humiliate, and intimidate the requesting spouse favors relief.

vi. **Legal obligation.** Where the couple's divorce decree, separation agreement or other legally binding document provides that the nonrequesting spouse bears sole responsibility for the tax liability, this favors relief. The opposite is true if the requesting spouse bears sole responsibility. If the divorce decree or legal agreement has the couple sharing responsibility, this factor is neutral.

vii. **Income tax compliance.** Complying with all income tax laws and obligations since the tax year at issue favors relief. Not complying weighs against relief, unless it is in difficult circumstances after the end of the marriage where the requesting spouse is nevertheless making good faith efforts to comply, where it is neutral.

viii. **Poor physical or mental health.** Being in poor physical or mental health at the time of signing the return, the time of requesting relief, or the time of the determination favors relief. A lack of health problems is neutral.

Available Blue J Products

Blue J's Innocent Spouse Relief Predictor can assist you in predicting court outcomes based on your specific set of facts. Blue J's Innocent Spouse Relief Predictor can save you valuable research time and find you the most relevant cases based on particular factors present in your situation.

Endnotes

1 IRS Publication 971: Innocent Spouse Relief.

2 As noted in Publication 971, (<https://www.irs.gov/pub/irs-pdf/p971.pdf>), community property states in this context re Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

3 I.R.C. § 6015(c)(3).

4 Publication 971 summarizes the different time frames for requesting equitable relief.

5 Treas. Reg. 1.6015-3(c)(2)(i) and (iii)

6 Treas. Reg. 1.6015-2(c).

7 See, for example, *Price v. Commissioner*, 887 F.2d 959, 965 (9th Cir. 1989).

8 See, for example, *Campbell v. Commissioner*, 91 T.C.M. 735, 740 (2006).

9 See, for example, *Rogers v. Commissioner*, T.C. Memo. 2020-91, at 18-19.

10 See, for example, *Haggerty v. Commissioner*, T.C. Memo. 2011-284, at 10.

11 More information can be found at Parts 25.15.1.2.3 and 25.15.1.2.4 of the Internal Revenue Manual, https://www.irs.gov/irm/part25/irm_25-015-001#idm140594057252624.

12 More information can be found at Publication 971, above.

13 See, for example, *Price v. Commissioner*, 887 F.2d 959, 965 (9th Cir. 1989).

14 See, for example, *Campbell v. Commissioner*, 91 T.C.M. 735, 740 (2006).

15 See, for example, *Rogers v. Commissioner*, T.C. Memo. 2020-91, at 18-19.

16 See, for example, *Haggerty v. Commissioner*, T.C. Memo. 2011-284, at 10.