

## Section 6015 Innocent Spouse Relief Made Easy

Nate Strand

January 15, 2012

“[Innocent Spouse](#) Relief” is when one person is relieved of liability for the other's taxes on a joint return. It is found in I.R.C. 6015. Under this section, there are three different grounds for Innocent Spouse Relief:

- (1) The person did not know about an erroneous understatement on a joint tax return, and it would be “inequitable” (unfair) to hold this person liable for that understatement.
- (2) The person is divorced or separated from someone with whom that person filed a joint return, and this person did not earn and did not know about the income in question.
- (3) Neither of the first two rules apply, but it would nonetheless be “inequitable” (unfair) to hold the person liable for the tax.

### **I.R.C. 6015(b): Innocent Spouse Relief when one party, unbeknownst to the other, messed up the tax return, and it would be “inequitable” to hold the other party liable**

If

- (1) there was a joint return filed
- (2) there was an understatement of tax on this return due to “erroneous items”
- (3) a person did not know or have reason to know of these “erroneous items”
- (4) it would be “inequitable” to hold this person liable, and
- (5) the [person files](#) for relief within two years of the beginning of collection,

then this person qualifies for Innocent Spouse Relief under I.R.C. 6015(b) with regard to the tax attributable to the “erroneous items.”

It's always easier to understand these rules if you use an example. Suppose Chloe and Yonah are a married couple. Suppose Chloe always does their taxes, and has for ten years now; Yonah hates it. But suppose this year she forgets. Can Yonah get Innocent Spouse Relief under I.R.C. 6015(b)?

The answer is “no.” The rule only applies where a joint return was filed, and the tax is due to “erroneous items” on that joint return. Chloe's failure to file doesn't give Yonah any relief. But now suppose Chloe does file the taxes, but the couple doesn't have enough money to pay them all. Again, Innocent Spouse Relief isn't available because the liability isn't due to “erroneous items” on the return.

Now let's change the story again. Suppose that Yonah is having an affair with his secretary, and that during the year, he secretly cashes out part of his retirement fund so the two of them can take a scandalous weekend trip to Tuscany. Now suppose that a year later - after Chloe filed her and Yonah's joint return - she receives a bill for unpaid taxes on the cashout of the [retirement account](#). Can Chloe get out of paying these under the Innocent Spouse Relief rule of 6015(b)?

The answer is probably yes, but she would have to establish that she didn't know about the retirement fund being cashed out, and had no reason to know about it. The liability in this instance is from a joint return, and due to an underreporting on that return; therefore, it meets the first requirements. Additionally, it is probably “inequitable” to hold Chloe liable.

Of course, “inequitable” is a rather vague standard. As will be explained, a taxpayer has the right to present their circumstances to the IRS and ultimately before a court with regard to their liability as an Innocent Spouse. Decisions by judges on the matter suggest that “inequitable” means that the tax liability is due to some kind of concealment or wrongdoing on the part of the other spouse, as opposed to merely misunderstanding the tax laws. *See, e.g., McCoy v. Commissioner*, 57 T.C. 732 (Tax Court 1972). When in doubt, use a common sense approach - “is this 'equitable', or fair?”

So suppose we change the story again; Yonah isn't having an affair with his secretary but instead is under the impression that he can deduct the cost of the new Maserati Quattroporte he bought to drive to work as a business expense. Even if Chloe doesn't know or have any reason to know that this deduction is wrong, it's probably not “inequitable” to hold her liable, since she signed a joint return, and the liability isn't based on any kind of fraud or wrongdoing by Yonah.

Note that if a person did know about the underreported income, but didn't know the full extent of it, that person is only liable to the extent of what this person knew. For example, suppose Chloe was making a lot of money on the side by selling a certain variety of brownies in town, and neglected to report \$300,000 in brownie sales income for the year. Suppose that Yonah knew about Chloe's brownie sales, but had no idea of the extent of it. Yonah could obtain Innocent Spouse Relief to the extent that he didn't know or have reason to know about the scope of Chloe's brownie sales, even if he knew about some of it.

Thus, to sum it up, the first ground for Innocent Spouse Relief can be boiled down to two basic things. First, there must be a tax liability due to erroneous reporting on the tax return. Second, the party must not have known or have reason to know about the income, and it must be “inequitable” to hold them liable for it. There is also the two year limitation to raise the issue, which begins at the point of collection.

Remember, however, that even if a person doesn't qualify for Innocent Spouse Relief under I.R.C. 6015(b), he or she may still qualify under one of the other two rules.

### **I.R.C. 6015(c): Innocent Spouse Relief when the parties are divorced, and the other party didn't earn and didn't know about the income in question**

If the parties are either

(A) divorced, or

(B) have been separated for 12 months

then a party who filed a joint return is not liable for taxes on income that this party did not earn and did not actually know about, or knew about but signed the return under duress. (there are also some special exceptions)

So let's go back to Chloe and Yonah. Suppose Chloe is in the process of divorcing Yonah since she caught him having an affair with his secretary, and has been separated from him for exactly twelve months. Now Chloe receives a letter from the IRS. Apparently Yonah sold some stock while the two were together which didn't get reported on the joint return. Can Chloe get out of liability for this under I.R.C. 6015(c)?

Probably, but it has to be the case that she didn't know about Yonah's stock sale.

At first glance, this rule doesn't appear to be too different from the first. The first rule required understatement on a joint return, lack of knowledge, and that it be “inequitable” to hold the party liable. This rule requires divorce or separation plus lack of knowledge. However, an importance difference between I.R.C. 6015(b) and I.R.C. 6015(c) is standard and burden of proof with regard to such

knowledge. For a filing under the first ground, the taxpayer must show that this party did not know, and had no reason to know of the understatement. Under this second rule, however, it is presumed that the party is not liable, and the burden is on the IRS to demonstrate *actual knowledge* of the income. Also, of course, there is no need to prove “inequitable” circumstances under this second rule.

So for example, suppose Yonah had the affair with the secretary, and in order to take her on a romantic getaway, he sold off his collection of over 200 vintage comic books to the tune of \$25,000. Under the tax code, this would be a gain to the extent that the \$25,000 exceeded his adjusted basis in the comics.

If Chloe were to claim Innocent Spouse Relief under I.R.C. 6015(b) (the first rule), she would have to prove that she didn't know he ever sold the comics, which might be difficult. However, if she were to claim the same relief under I.R.C. 6015(c), she doesn't have to prove anything; it would be up to the government to prove that she knew about the sale of the comics. In the second rule, the default position is that Chloe is not liable. The distinction is important because so very many disputes involve questionable evidence, making the burden of proof and the default position very important.

Now as mentioned, there are a few special qualifications to this second ground for Innocent Spouse Relief. The first is the “disqualified asset” rule of 6015(c)(4). This rule has two parts.

First, even if liability is separated under 6015(c) (i.e., the taxpayer has lack of knowledge and shows divorce or separation), the taxpayer's liability is increased by the value of any asset which is transferred to the individual for the principal purpose of avoiding tax or the payment of tax. Such asset is considered a “disqualified asset.”

Second, any property transferred between spouses within one year before the date of the first proposed deficiency by the IRS, or any time after, is *presumed* to be a “disqualified asset” - transferred to avoid tax or the payment of tax - unless it was pursuant decree or written instrument, incident to a divorce, which establishes otherwise.

So let's change our story once again. Suppose that Yonah caught Chloe having an affair with a bluegrass musician, and is now divorcing her. Also suppose that the two of them owe about \$250,000 in back taxes because Yonah was underreporting his income numbers from his limousine business, and that this deficiency has been assessed and is in collection. In this situation, Chloe could file to eliminate her liability on that \$250,000, since there's no evidence that she knew about it.

Here's the thing. Because the first deficiency has already been proposed, any transfer to Chloe by Yonah at this point will be presumed to be a “disqualified asset” which will increase her tax liability by its value. It will be up to Chloe to demonstrate that this property was not transferred to avoid tax or the payment of tax. For example, suppose Yonah offers Chloe \$5,000 from his bank account to Chloe at the beginning of the divorce, in lieu of paying alimony. Chloe's tax liability will still be increased, unless it's clear from the instrument that the purpose of the transfer isn't to avoid tax or the payment of tax.

(this is why it's important to have a smart lawyer)

As you might guess, if the separation of liability under the second Innocent Spouse Relief rule is successful, then each person will take his or her income, credits, and deductions as if this person would've filed separately. However, there are three qualifications to this rule.

The first is the rule of I.R.C. 6015(c)(3)(A) for where the “spouse benefits.” Normally, the deficiencies of a tax return are allocated to the spouse whose actions gave rise to them accordingly. However, if the item giving rise to a deficiency benefited the other spouse, then it will be allocated to that spouse.

The second rule is that if the parties cease to get a credit or deduction that they otherwise would've received as the result of computing their liabilities separately, this credit or deduction is still taken into account, but is divided equally on the split return.

The final rule is that income imputed with regard to a child is disregarded in determining separate liability, and that such liability is divided appropriately between the spouses.

Thus, while the rule has some complicated nuances, essentially, taxpayers may be relieved of liability for the taxes of an ex spouse which were due to income they did not know about at the time the return was signed.

However, even if neither this nor the first rule proves to help a taxpayer, the final ground for Innocent Spouse Relief might.

**I.R.C. 6015(f): Innocent Spouse Relief when neither of the other two rules apply, but it would nonetheless be “inequitable” to hold the person liable**

Many courts look to to what extent the spouse received a benefit from the understatement of tax as the most important factor. *See, e.g., Reser v. Commissioner*, 112 F.3d 1258, 1262-63 (5<sup>th</sup> Cir. 1997). Some decisions have held that one spouse's reliance on the other can be the basis for eliminating liability for penalties under this “inequitable” standard. *See, e.g., Cheshire v. Commissioner*, 115 T.C. 1983 (Tax Court 2000).

But of course, that's just one of countless circumstances where the rule could apply. Suppose Yonah runs off with his mistress on April 14 with all the money in the bank, and leaves Chloe stuck holding the bag - even though she knew about all the income. The genius of rules like I.R.C. 6015(f) is that they are flexible and can be potentially used in a variety of situations.

Of course, before you do that, call me. Or someone like me.

Innocent Spouse Relief is achieved by filing and demonstrating the appropriate facts with the specific IRS unit, which is in Kentucky. One of the problematic things about the filing is that the other spouse must be notified, even in cases of domestic violence. However, after the filing is made, the IRS will make its decision after a few months, though it may take longer. If a taxpayer is not satisfied with this decision, this person gets a chance to go to court over it.

Thus, Innocent Spouse Relief serves an important purpose in American tax law, where joint returns are a notable exception to the general rule that individuals are only liable for themselves. For more information you can consult the IRS or one of several other reference sites. Or me.

