

## Innocent Spouse Relief Provisions

The Internal Revenue Code has contained so-called “innocent spouse” relief provisions since 1971. These rules were most recently revised in 1998 to provide more liberal relief for persons seeking relief from joint and several liability arising on a joint return filed with a spouse or former spouse.

Under the revised rules, a person may obtain innocent spouse relief in one of three ways. She/he may obtain relief if she/he establishes: (1) she/he had no knowledge of or reason to know of the erroneous item creating the deficiency and it would be inequitable to hold her/him liable i.e., lack of knowledge relief), or (2) she/he is eligible for separate return relief (“separate return relief”) and she/he is no longer married or living in the same household as the spouse with whom she/he filed the joint return, or (3) even though she/he fails to qualify under either of the above two grounds, it would be inequitable to hold the person responsible for the deficiency (“equitable relief”). In some cases, relief is available even after the death of the innocent party. In all cases, the spouse must seek relief within two years after the IRS has commenced collection activity. Moreover, a transfer of assets between spouses that amounts to a fraudulent scheme would result in no possibility of innocent spouse relief. The standards that apply generally in determining whether relief is available under any of these grounds and the availability of judicial review is set forth herein.

Grounds For Relief / Lack of Knowledge Relief. A spouse may obtain relief from and several liability if she establishes that: (1) she had no knowledge or reason to know of the erroneous item resulting in the deficiency, and (2) under all of the circumstances it would be inequitable to hold her liable for the deficiency. In determining whether the spouse had knowledge or reason to know of the deficiency, the IRS will consider whether she was put on notice of the erroneous item. In most cases, she has a duty of inquiry regarding items stated on the return, as well as unusually large expenditures or sums of money that are unexplained. Often, the spouse’s level of education is a factor in determining whether she had reason to know of an item. However, a lack of sophistication in financial affairs will not absolve from responsibility a spouse who, given suspicious circumstances, reasonably should have known of an erroneous item or an omission of income.

Relief also is available if the spouse is able to establish that she had no knowledge or reason to know of only a portion of an erroneous item. In this case, relief is granted with respect to that portion of the deficiency attributable to the erroneous item of which she had no

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knowledge or reason to know.

In determining whether it is inequitable to hold a spouse liable for a deficiency, the IRS will consider whether the spouse obtained a significant benefit from the omission or erroneous deduction. Such a benefit would include any support beyond what was normal for the couple under the circumstances. Lavish expenditures beyond normal support would constitute a significant benefit and would operate against a grant of relief. Other factors in determining equitable circumstances include: (1) whether the spouse seeking relief would suffer economic hardship if held liable for the deficiency, and (2) whether this spouse has made a good faith effort to comply with the income tax laws in years following the deficiency year(s).

Separate Return Relief. A spouse who no is longer married to or living in the same household as the spouse with whom she filed the joint return may seek separate return relief. In this case, relief is never available if the IRS establishes that the spouse seeking relief had actual knowledge of the erroneous item. However, if the spouse is the victim of domestic abuse and the abuse prevented the spouse from challenging the return's treatment of an item as a result of a fear of retaliation, the restriction on actual knowledge will not prevent separate return relief. Independently of this avenue of relief, if the joint return was filed under duress, the spouse may proceed under separate rules to disavow the joint return. In this case, the return is adjusted to reflect only the tax liability of the innocent spouse and the tax is determined by applying the rates for married individuals filing a separate return.

Separate return relief is particularly advantageous because it allows the spouse to determine her tax liability as if she had filed a separate return. IRS regulations detail the various permissible methods of allocation of items from a joint return.

Equitable Relief. If the spouse fails to establish entitlement to relief under the two methods described above, she may apply for equitable relief. The IRS will consider the following circumstances under which it would be inequitable to hold the spouse liable for the deficiency:

- Marital status (does the innocent spouse anticipate the return to the household of the other spouse?)
- Economic hardship (would collection of the deficiency result in an inability of the

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spouse to provide herself normal support?),

- The extent of the spouse's knowledge or reason to know of the erroneous item (determining the level of complicity in the omission or erroneous item),
- Significant benefit (whether the innocent spouse received benefit beyond normal support from the omission or erroneous item),
- Whether the innocent spouse has complied with income tax laws following the years in question, i.e., whether this spouse has acted responsibly in meeting her tax obligations, and,
- Whether the innocent spouse suffered domestic abuse (i.e., whether the deficiency is attributable to the spouse's inability to safely challenge her spouse's actions).

A spouse must establish entitlement to equitable relief to obtain a refund of an overpayment or to establish relief from an underpayment. Such relief is available only in circumstances detailed in IRS guidance.

Judicial Review. Judicial relief is available if the IRS denies administrative relief. A spouse who has filed a claim for innocent spouse relief may seek judicial review of an IRS denial of relief. There are time limits regarding the filing of a petition with the Tax Court that apply regardless of whether the IRS renders a determination after administrative review. In addition, the spouse may challenge an IRS assessment in federal district court on the ground that she is entitled to innocent spouse relief. Because in most cases the entire tax must be paid in order to seek relief in federal district court, many spouses choose to establish innocent spouse relief by filing a petition for relief in the Tax Court before paying of the deficiency. In a petition filed in the Tax Court, the other signatory to the joint return is entitled to intervene in the proceedings to either support or oppose the spouse's right to relief from joint and several liability.

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