

Equitable Relief from Joint and Several Tax Liability

Taxpayers who file jointly become legally responsible for the entire tax liability related to the filing, even if the taxpayers later divorce or separate. The IRS offers some relief for a spouse under certain conditions, and a new notice extends the filing periods for requesting equitable relief.

On July 25, 2011, the Internal Revenue Service issued Notice 2011-70, which provides a longer filing period for individuals requesting *equitable relief* from joint and several tax liability. Until now, the presumed time frame was within two years from when the IRS's first collection activity is launched against the requesting spouse. With Notice 2011-70, the time frame now depends on whether the taxpayer has a balance due or is seeking a credit or refund. In the case of a balance due, the time frame is within 10 years from the date the tax liability is assessed. If the taxpayer is seeking a credit or refund, the time frame is the later of three years after the date the original return was filed or two years after the date the tax was paid.

Joint and Several Liability

When taxpayers file a joint tax return, the law provides a legal bond between the couple whereby

each spouse assumes the responsibility for the entire tax liability regardless of who earned the income. Internal Revenue Code (IRC) §6013(d) provides that if a joint return is filed, the tax shall be computed on the aggregate income, and the liability shall be joint and several. Further, IRS Publication 971 provides that the taxpayers' liability extends not only to the tax liability shown on the tax return but also to any additional tax liability determined by the IRS as well as any interest and/or penalties resulting. Still further, the liability can be collected from either taxpayer even if the taxpayers are now divorced and the divorce degree states that one of the former spouses is responsible.

The IRC does provide relief from some or all of the tax liability for a spouse, or former spouse, under certain conditions. The three types of relief that are available to a married couple that files a joint tax return are: (1) innocent spouse relief, (2) separation of liability relief, and (3) equitable relief. In the case of a married couple that doesn't file a joint return but lives in a community property state, a spouse may still be able to seek relief under these provisions.

To seek relief under any of these

provisions, a spouse needs to complete Form 8857 and submit it to the IRS. Form 8857 covers three years, which means the spouse will need to complete multiple Form 8857s if more than three tax years are in question. The spouse completing Form 8857 is the one seeking relief and is referred to as the requesting spouse. Conversely, the nonfiling spouse is referred to as the nonrequesting spouse (Reg. §1.6015(h)). The IRS will review the completed form and inform the requesting spouse whether he or she qualifies for relief.

It's important to be aware that the IRS is required by law to notify the nonrequesting spouse that a Form 8857 has been filed. This notification is required even if the requesting spouse is the victim of spousal abuse or domestic violence. But the IRS does state in Publication 971 that it doesn't disclose personal information such as current name, address, phone number, employer, or any other information not related to making a determination about the request for relief. Thus, some identity protection is provided.

The requesting spouse can petition the U.S. Tax Court to review the request under one of two situations. The first situation is if the

requesting spouse receives a final determination by the IRS. Presumably, this is only necessary in case of a denial. The second situation is if the requesting spouse doesn't receive a final determination letter from the IRS within six months from the date the Form 8857 is filed.

Relief from Liability

IRC §6015(b) provides the general rules for a spouse seeking tax relief under any of the three types of joint and several liability relief. To begin, the requesting spouse had to have filed and signed a joint return with the nonrequesting spouse for which an understatement of tax exists for erroneous items of the nonrequesting spouse. The requesting spouse also must establish that he or she didn't know or have reason to know that there was such an understatement. In addition, it would be inequitable to hold the requesting spouse liable for the deficiency in tax due to the understatement after taking into account all the facts and circumstances.

Finally, the requesting spouse must file for relief under the innocent spouse relief or the separation of liability relief within two years after the date the Secretary of the Treasury has begun collection activities. (The timing for filing under equitable relief is discussed later.) A collection activity is seen to occur when:

- ◆ The IRS offsets a taxpayer's income tax refund against a previously owed tax on a joint tax return and the Service informs the taxpayer about his or her rights to file Form 8857;
- ◆ The filing of a claim by the IRS

- in a court proceeding involving the taxpayer and his or her property, including a bankruptcy proceeding or the filing of a suit by the U.S. against the taxpayer to collect the joint liability; or
- ◆ The issuance of an IRC §6330 notice, which notifies the taxpayer of the IRS's intention to levy the taxpayer's right to a collection due-process hearing.

In the case of separation of liability relief, the requesting spouse must satisfy one of two additional criteria: (1) that the requesting spouse is no longer married to or is legally separated from the nonrequesting spouse, or (2) during the 12 months prior to seeking relief, the requesting spouse wasn't a member of the same household as the nonrequesting spouse with whom the joint tax return was filed. (See Publication 971 for details on this type of relief.) It's important to realize that the burden of proof rests on the shoulders of the requesting spouse.

Equitable Relief

If a taxpayer doesn't qualify under either the innocent spouse relief or the separation of liability relief criteria, he or she may seek equitable relief under IRC §6015(f). Equitable relief is broader than the other two types because it can be requested for either an understated tax liability or an unpaid tax liability. An unpaid tax liability is one where the correct tax liability was reported on the tax return but not paid by the couple.

As a result of Notice 2011-70, the period within which the requesting spouse is able to seek

equitable relief from joint and several liability under IRC §6015(f) was expanded effectively on July 25, 2011. In the case of a balance due, the requesting spouse must file Form 8857 within 10 years from the date the tax liability is assessed. If the requesting spouse is seeking a credit or refund, the time frame is the later of three years after the date the original return was filed or two years after the date the tax was paid. If the requesting spouse is seeking a credit or refund, he or she must file Form 8857 within three years after the date the original return was filed or two years after the date the tax was paid, whichever is later. An additional grace period is provided in the situation where the requesting spouse lives in a federally declared disaster area or becomes physically or mentally unable to manage his or her financial affairs (see IRS Publication 556 for details). This time extension doesn't apply to either the innocent spouse relief or separation of liability relief.

Factors for Granting Equitable Relief

The IRS has indicated that it will consider all facts and circumstances in order to determine whether it's unfair to hold a requesting spouse responsible for the understated or underpaid taxes. Hence, it's critical that clear and detailed information be included on Form 8857 where explanations are requested. Moreover, the requesting spouse bears the burden of proof to show that:

- ◆ All the requirements for waiver

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- of joint and several liability are satisfied;
- ◆ He or she didn't have actual knowledge or reason to know about the understated or underpaid taxes; and
- ◆ He or she didn't transfer property to avoid tax.

Prior Requests

Notice 2011-70 may be relied on until Treasury revises IRC §6015(f). In addition, it provides some transitional rules that taxpayers may follow until then. For example, the IRS will consider requests for equitable relief if they already have been submitted, even if the request is beyond the two-year time frame. More importantly, requesting spouses who were denied equitable relief solely for untimely filing and did not litigate the issue in Tax Court may reapply for relief under IRC §6015(f). If the requesting spouse currently is litigating the denial because of an untimely filing, the IRS or Tax Court will take appropriate action to be consistent with the Notice 2011-70. As a result, the question faced by a prior requesting spouse is whether the door of opportunity is still open to file for equitable relief. If so, one should consider taking action on behalf of the client. **SF**

Anthony P. Curatola is the Joseph F. Ford Professor of Accounting at Drexel University in Philadelphia, Pa., and a member of IMA's Greater Philadelphia Chapter. You can reach Tony at (215) 895-1453 or curatola@drexel.edu.

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