

# Expansion of Equitable Relief Rules

A recent ruling sustained the Tax Court's right to apply a de novo standard and scope of review in cases where an individual is requesting equitable relief from a federal income tax liability created or attributable to a former spouse. The IRS disagrees with this position but won't argue the Court's right to apply it.

Individuals seeking equitable relief from a federal income tax liability created or attributable to a former spouse must first petition the Internal Revenue Service (IRS) for equitable relief from joint and several tax liabilities as an innocent spouse. This often is a bumpy road for petitioners, but there's some good news. This petition has been treated more favorably over the past few years in court rulings and IRS revenue procedures. The latest IRS guidance, a proposed revenue procedure for equitable relief, was issued January 5, 2012, in Notice 2012-8, which supersedes previous guidance and provides factors for the individual to satisfy when requesting relief. In July 2011, the IRS issued Notice 2011-70, which extends the filing period for those individuals requesting equitable relief from joint and several tax liabilities (see April 2011 Taxes column).

This extension of time has led to another more critical question facing the individual: What information can be provided to the Tax Court when it is reviewing a request for equitable relief? More specifically, is the Tax Court limited to the administrative record information, or can the individual present new information that arises after the IRS administrative record ruling? In light of recent court holdings, the courts have held that they aren't restricted to the administrative records information in the matter of equitable relief. Rather, they will consider new information that may provide the appropriate relief in these situations. Better yet, the IRS has acquiesced to these rulings.

## Equitable Relief under IRC §6015(f)

In *Karen Marie Wilson v. Commissioner of Internal Revenue* (T.C. Memo 2010-134), the Tax Court found that an individual seeking equitable relief from the joint and several liabilities with a former spouse needs to satisfy either the three safe harbor factors or the eight-factor balancing test set forth in Rev. Proc. 2000-15, 2000-1 C.B. at 447. The three safe harbor factors are set forth in §4.02 of Rev.

Proc. 2000-15. Although the IRS will now apply the provisions of the proposed revenue procedure in Notice 2012-8, the Court's decision in *Wilson* that applied the superseded Rev. Proc. 2000-15 C.B. at 447 is still relevant regarding the basis of evidence presented at trial.

Under the safe harbor test, the individual requesting relief must satisfy all three factors to be granted equitable relief. First, he or she is no longer married to and hasn't been living with the former spouse at any time in the 12-month period prior to requesting the relief. Second, he or she had no knowledge or reason to know that the tax wouldn't be paid. Third, he or she would suffer economic hardship if relief isn't granted. For all three factors, the individual requesting relief has the burden of proof and thus needs to provide evidence to substantiate the alleged claims.

If the petitioner is unable to satisfy the three-factor safe harbor test, he or she must satisfy the eight-factor balancing test. As noted by the Tax Court in *Wilson*, these factors aren't exhaustive; rather, they may be the starting point for the IRS Commissioner. Hence, there could be more than eight factors considered. The eight factors are (1) marital status,

(2) no knowledge or reason to know, (3) economic hardship, (4) abuse present, (5) nonrequesting spouse or requesting spouse's legal obligation, (6) attribution to nonrequesting or requesting spouse, (7) significant benefit, and (8) noncompliance with federal income tax laws. The IRS will consider all facts and circumstances. Keep in mind, no single factor will determine whether to grant equitable relief, and some factors are weighed more heavily than others. If present, factors 1 (marital status) and 4 (abuse) are positive factors for granting relief, while factors 7 (significant benefit) and 8 (noncompliance with federal income tax laws) are negative factors. The other factors (2, 3, 5, and 6) can be either positive or negative factors for granting relief if they're present. It should also be noted that factors 1-3 are modified versions of the three safe harbor rules.

### Karen M. Wilson Case

In *Wilson*, the Tax Court held that it had the authority to consider information outside the findings in the "administrative record" provided by the appeals officer of the IRS. Specifically, the Tax Court ruled that it would apply both a de novo standard and a de novo scope of review based on evidence presented at trial and not just the administrative record. This position was sustained by the Ninth Circuit Court of Appeals, 111 AFTR 2d 2013-522. As a result, the IRS Commissioner issued an Action on Decision, AOD 2012-07, IRB 2013-25, June 17, 2013. In the AOD, the IRS said it disagreed that IRC §6015(f) provides a de novo stan-

dard and scope of review to the Tax Court, but it stated that it wouldn't argue the Tax Court's right to apply it. The de novo scope of review provides the petitioner the ability to introduce new evidence. The 11th Circuit Court of Appeals gave a similar ruling in *Commissioner v. Neal* (103 AFTR 2d 2009-8) concerning the scope of the Tax Court's review under IRC §6015(f).

Wilson sought equitable relief from the IRS's ruling in the Tax Court in 2005. During this trial, complicated facts and legal issues unfolded that resulted in pro bono counsel being provided. A second trial was granted by the Tax Court in 2008, at which time new information was offered to the Court. Without the introduction of new information, the Tax Court more than likely would have ruled for the Commissioner. The first piece of new information introduced was Wilson's marital status, which changed from married and living in the home of her spouse at the time she petitioned for equitable relief to divorced and living separately from her estranged spouse. This factor is seen to weigh strongly in favor of granting Wilson equitable relief under the eight-factor balancing test. If this factor had been presented when she originally sought relief, she would have satisfied the safe harbor rules.

The second factor is the later compliance with federal tax laws. In Wilson's case, she testified she owed a small amount of tax in 2001 and 2002, which she paid. The Tax Court also found on de novo review that Wilson owed approximately \$2,000 for 2004, a year following her IRS request for

equitable relief. The Tax Court noted that it's unclear whether she satisfied this debt since she failed to provide any evidence to resolve this matter. Yet the Court found it probable she would resolve this liability since she did so in the prior situation. Acknowledging that her bad faith (failing to provide evidence) weighed against her request, the Court held it to be only slightly weighing against her.

The third factor is her knowledge or reason to know of the underpayment. Wilson originally failed to provide the appeals officer with evidence of what she knew about the underpayment when she signed the tax return. Thus, the factor would weigh negatively for her request. But upon de novo review, the Court learned Wilson reasonably believed her spouse would pay the tax liability in light of their current income and assets in comparison to the amount owed. Wilson, however, didn't know that the U.S. Securities & Exchange Commission had issued a cease-and-desist order to her spouse, which significantly changed their income status. As a result, the Court found she lacked reason to know that her spouse would be unable to pay the liability.

The fourth factor pertains to whether she would suffer economic hardship if she had to pay the liability. Wilson claimed that her monthly income after expenses was \$114, which is insufficient to repay the tax liability of \$540,000. Again, she originally failed to substantiate her expenses as requested by the appeals officer. Hence, the factor weighs negatively for her request in the administrative record. The Court

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found that she lived in a modest home, supported a son who was a minor, and had incurred a credit card balance of \$20,000 for necessary expenses. These later findings were seen to significantly influence the weighing of this factor for the requested relief.

### Providing Information

There are several things to take away from the findings in *Wilson* as well as the Commissioner's decision to acquiesce to the review limitation despite disagreeing with the position held by the Tax Court. To begin, an individual requesting equitable relief from joint and several tax liabilities does have the ability to present at Tax Court any additional or revised information that wasn't included in the administrative records from the appeals officer. But a more important takeaway is the need for the petitioner to provide complete and accurate information supporting all of the factors as set forth in the proposed revenue procedure Notice 2012-8 as well as future revenue procedures on equitable relief. One shouldn't assume the Court will be so forgiving for failing to provide complete and accurate information when requested by the appeals officer. **SF**

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