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# 'Innocent Spouse' Tax Relief: Facts and Circumstances Will Prevail

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One of the more challenging issues an accountant or attorney will face is when a client receives a notice from the Internal Revenue Service assessing additional tax, penalties and interest. It can become even more interesting when the IRS is assessing significant penalties for intentional understatement, and the client has no idea where the notice came from, where the alleged understatement occurred, and claims not to have signed the tax return. The fact that the client professes no knowledge of the underlying audit or the significant errors and omissions on the tax return will, in a few circumstances, lead the practitioner to discuss the possibility that "innocent spouse" protection may apply.

If the issues being addressed by the IRS notice relate solely to one spouse, and the other spouse knows nothing of either the audit or the issues, it is important to investigate the facts and

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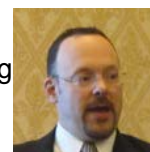


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circumstances pertaining to the client. In some instances, there may be protection for the so-called "innocent" spouse from collection efforts against his or her separate assets by the IRS. Knowing when or if this protection is available, and how to react early in the process, can make a significant difference in the ultimate outcome.

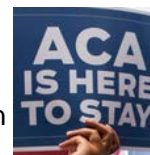
While generally the IRS believes that both individuals named on a joint tax return are jointly and severally liable for all amounts found to be due to the government, there are exceptions.

Innocent spouse relief may be available in circumstances where the husband or wife has materially understated income, overstated expenses and/or underpaid taxes on a married-filing-jointly tax return. Understanding how the IRS regulations and the application will affect a particular set of circumstances should be undertaken early on in the representation, and especially before any additional filings or responses are made with the IRS.

Generally, taxpayers filing a joint return are routinely jointly and severally liable for any resulting tax, including penalties and interest. This means that the IRS may collect the entire amount due from either spouse. Internal Revenue Code Section 6015 is the underlying support providing the basis for relief in certain circumstances.

One example might be a couple filing an amended tax return showing new or changed outside information, leading to a refund being due from the IRS. Perhaps it includes an amended K-1 from a partnership or a correction of the cost/basis in a stock that was sold during the year. Upon examination, the IRS determines the filing contained false or otherwise inaccurate information. (This article does not address the underlying reasons why such a return may have been examined in the first place.) The IRS might attempt to levy joint bank accounts as well as bank accounts in either the husband's or wife's name. If John Smith filed a false informational tax return and he deposited into his personal account an IRS refund check based on the amended return, but Jane Smith, the innocent spouse, was completely

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unaware of the fraudulent issues with the return, did not participate in any benefit from the refund and properly followed the IRS procedures, Jane Smith would likely be eligible for innocent spouse relief if the IRS attempted to levy her personal bank account in a collection effort.

As the courts have gone through many of the issues that come before the judiciary, it is clear that individual facts and circumstances are reviewed quite specifically, and small differences in the fact pattern can make a significant difference in the outcome. There are several issues that are routinely taken into account, either by practice or by regulation, to guide the IRS (or the courts upon appeal) to a determination of whether an individual can avail himself or herself of innocent spouse protection. Interestingly, one of the factors taken into account is whether, after the point in time when the tax matters arose, a separation or divorce has taken place. (This can be further complicated for same-sex couples in today's climate, with many states not yet having caught up with *United States v. Windsor*, 570 U.S. \_\_\_\_ (2013), with regard to the implementation of divorce statutes.) The IRS will routinely take into account whether the innocent spouse derived the benefits from the understatement of income (or overstatement of the deduction), and whether the innocent spouse has or should have had knowledge of the tax underpayment, including whether the innocent spouse had a reasonable basis to assume there were sufficient marital assets to pay the tax liability. In addition, whether the innocent spouse would suffer significant economic hardship is taken into account. These various factors have been considered both in terms of the regulations and the judicial record.

IRC Section 6015 offers three types of relief. In addition, Revenue Procedure 2013-34 provides a methodology for evaluating claims for "equitable relief" under Section 6015(f). In a circumstance where it can be shown that the tax return was signed under duress, innocent spouse relief is available because the return is ultimately deemed not to have been jointly filed. In these circumstances, the liability will generally go totally to the spouse who created the duress. Interestingly, the threat against children of the marriage has been deemed to be the equivalent of forcing a signature under duress. In the

case of *Harris v. Commissioner of IRS* in 2012, Docket No. 18413-10 (Filed December 3, 2012), the U.S. Tax Court held that there was evidence of physical abuse of the children even though there was no allegation of direct abuse against the requesting spouse. The court recognized the threat of abuse to the children was sufficient to be deemed a material factor in forcing the innocent spouse to sign a return without having a chance to properly review it.

The IRS will look, inter alia, at the sophistication of the taxpayer claiming innocent spouse protection. It's much more difficult for a chief financial officer with years of tax return preparation experience to make a claim of innocent spouse as compared to an individual who worked in the house, never completed college or never maintained a home checkbook. Reviewing the types of errors that occurred on the return will also be considered along with the knowledge, sophistication and background of the spouse. While the innocent spouse may be aware that her husband is involved in horse racing, she may have no idea what the appropriate deductions are under the Internal Revenue Code. She may not, therefore, have any way of understanding that completely erroneous depreciation methodologies were used and that the husband was taking all the additional cash and spending it on his mistress. While it is difficult to define, the IRS will look to the definition of what a reasonable person would have been expected to raise in the way of questions, and whether the erroneous item represented a material departure from the recurring pattern of prior tax returns. This item may be less applicable for newly married couples if no prior joint tax returns have been filed and the requesting spouse did not have access to the prior tax returns of the other spouse.

The rules for requesting relief under the innocent spouse provisions are particularly complex and subject to the facts on hand. One alternative available to an individual concerned about his or her spouse's failure to properly file tax returns accurately is to file "married filing separately." The history of many of these cases makes it clear that filing joint tax returns opens up new questions that must be addressed based on knowledge, trust and keeping your eyes open.

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