NAVIGATING THE CHANGING GUIDELINES & PERSPECTIVES FOR POSSIBLE INNOCENT SPOUSE RELIEF

AUSTIN TAX STUDY GROUP
MARCH 18, 2014

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John C. Blazier founded Blazier, Rutland & Lerner, P.C. in 1976, and has remained the President of the Firm, now Blazier, Christensen, Bigelow & Virr, P.C. He earned his B.A. degrees at the University of Texas at El Paso in 1966, then attended the University of Texas School of Law where he was editor-in-chief of the Law Forum and was published in the Texas Law Review. He received his J.D. and was admitted to the Texas Bar in 1969. He is also licensed to practice before the U.S. District Courts of the Western, Eastern, and Southern Districts of Texas, as well as the U.S. Tax Court.

Following law school, Mr. Blazier entered the U.S. military, serving in Vietnam. He was awarded the Bronze Star on two occasions, as well as a Military Service Medal. Upon return from active duty, he served in the Texas National Guard, attaining the rank of Lt. Colonel, and was employed by the IRS Estate and Gift Tax Division, Austin, District. Here he gained significant insight into complex tax matters and business valuation. Using his GI Bill, he then attended New York University School of Law, where he completed his L.L.M. in taxation.

Blessed with an active business practice, Mr. Blazier is keenly aware of the tax implications of various business transactions. He serves as corporate counsel for a number of mid-sized companies, handling numerous complex corporate matters, from acquisitions and restructuring, to employment law issues as well as working with individual clients, public organizations and churches. He acknowledges he is a teacher, striving to help clients understand the tax implications in their planning process, whether in personal estate planning or the corporate setting.

Mr. Blazier is an active member of the American Bar Association and the Travis County Bar Association. He is a passionate leader in the Austin community for systemic change in public education. He is the founder of the Seedling Foundation, which provides mentors for children of incarcerated parents and works with the Austin Independent School District for campus beautification. He has served as Chair of Austin Partners in Education (2002-2003) and helped implement a number of initiatives, such as seeking logistical technology support from governmental entities and private businesses for high schools and middle schools in AISD. As an active community leader, John worked to help build school to career pathways and facilities, such as the Institute of Hospitality and Culinary Arts at Travis High School, the Auto Collision and Repair Facility at Crockett High School, and the Kocurek Health Science Institute at Lanier High School.

Mr. Blazier has been recognized for his commitment to children with the awards of Five Who Care and 2001 Partner of the Year by the Travis Education Foundation. An AISD elementary school has been named for him.

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WORKING WITH THE FACTS AND CIRCUMSTANCES TO PREVAIL IN THE PRESENTATION FOR THE INNOCENT SPOUSE

I. INTRODUCTION

A. The primary focus of this paper will be to examine in detail the provisions of ***Section 6015*** of the Internal Revenue Code related to relief for the innocent spouse taxpayer who filed a joint return. There is a separate provision ***Section 66 (c)*** for taxpayers who have community income and did not file a joint return. ***Section 66 (c)*** allows the Commissioner to disregard community property laws as to any income if such taxpayer acted solely in their individual capacity as to such income and did not notify the taxpayer spouse and the parties did not file a joint return. These provisions have been in the Internal Revenue Code since 1971. In 1998, a Congressional hearing raised the awareness of the challenges facing taxpayers, primarily women who were seeking relief as an innocent spouse and ***Sections 66(c)*** and ***6015*** were broadened. Innocent Spouse provisions were substantially expanded in 1998 and the initial guidance was set out in ***Rev. Proc. 2000-15.***

B. The ability to meet the criteria to qualify as an innocent spouse who filed a joint return has been challenging since ***Section 6015 and 66 (c)*** were included in the Internal Revenue Code in 1971. The IRS was given considerable latitude with the addition of ***Section 6015 (f)*** to review the "facts and circumstances". Congressional authority was given to the IRS to prescribe the conditions and facts that a taxpayer must meet to qualify for innocent spouse status under ***Section 6015(f).*** In 2003, the IRS provided further guidance in ***Rev. Proc. 2003-61*** and for a decade this Rev. Proc. has been extremely important for taxpayers asserting that they are an innocent spouse. Working in updating the guidance for ***66(c) IRC*** and ***6015*** became public with ***Notice 2012-8*** and the IRS issued ***Rev. Proc. 2013-34*** which made a number of substantive changes. While several Tax Court cases contain language that the Court is not bound by the conditions or factors, the Tax Court judges use the IRS conditions and factors and the only variable is how the Court views the taxpayer's evidence in relationship to the conditions and factors. In this area of law, the conditions and factors are truly on equal footing with the statutory provisions of the Internal Revenue Code.

C. The Internal Revenue Service ("IRS" or "Service") has recently issued new guidance in ***Rev. Proc. 2013-34***, and made five major changes:

1. consideration of the mental and physical health of the taxpayer;

2. expansion of the definition of abuse;

3. taxpayer knowledge will no longer be given additional weight if it is a negative factor;

4. provides for an expedited review process in the event of substantial hardship; and

5. substantially increases time for filing for relief under ***Section 6015(f).***

The time for filing relief under ***Section 6015(f)*** is before the expiration of the period of limitation for collection under ***Section 6502*** to the extent the taxpayer seeks relief from an outstanding liability, or before the expiration of the period of limitation for credit or refund under ***Section 6511*** to the extent the taxpayer seeks a refund of taxed paid. Abuse is important in the IRS consideration and application to its evaluation of the requesting taxpayer's application for innocent spouse tax status.

I will begin with a focus on the relevant provisions of the Internal Revenue Code beginning with authority to file a joint return ***Section 6013*** and ***Section 6013 (a)*** the provision for joint and several liability. With this background, attention will focus ***Section 6615*** that lists the requirements a taxpayer who filed a joint return must meet to be eligible for consideration as an innocent spouse. From the outset, it is important to understand that each exception sets out tests that the taxpayer must meet. All the tests must be met to even get into a position where the Service will look at the "Facts and Circumstances". This is an area where the IRS has the broadest of discretion and each case turns on its individual facts and circumstances.

I will address a number of the key cases in the context of the factual inquiry by the Service for each of the hurdles a taxpayer must successfully overcome to be considered eligible to be treated as an innocent spouse. A key issue in several aspects of IRS inquiry brings into question whether the person seeking innocent spouse status acted under duress. This is an area where I believe the IRS and the Tax Court considers the subtle reality of the psychological ramification of the many types of conduct that truly destroy one spouse's ability to function and make independent decisions. In fairness to those who weigh the issue of "abuse," they are not psychiatrists or psychologists. Perhaps the tax lawyers and Certified Public Accountants who present these cases have not provided qualified third party evidence to sensitize and educate IRS Appellate Conferees and Tax Court Judges regarding the extensive scientific knowledge that has been developed in this critical area of spousal behavior and relationship. If the innocent spouse matter arises from a tax shelter case, there are a number of additional issues that will be briefly noted. Finally, I will share some practical considerations in preparation that one might find helpful in innocent spouse cases.

II. JOINT RETURNS - JOINT AND SEVERAL LIABILITY THE BASIS FOR LIABILITY

A. I am certain that most taxpayers have little, if any, understanding of the ramifications of filing a joint return. ***Section 6013 (a)*** provides:

A married couple may make a single return jointly of income taxes under subtitle A, even though one of the spouses has neither gross income nor deductions, except as provided below:

1. no joint return shall be made if either the husband or wife at any time during the taxable year is a nonresident alien;

2. no joint return shall be made if the husband and wife have different taxable years; except that if such taxable years begin on the same day and end on different days because of the death of either or both, then the joint return may be made with respect to the taxable year of each. The above exception shall not apply if the surviving spouse remarries before the close of his taxable year, nor if the taxable year of either spouse is a fractional part of a year under ***Section 443(a) (1);***

3. in the case of death of one spouse or both spouses, the joint return with respect to the decedent may be made only by his executor or administrator; except that in the case of the death of one spouse, the joint return may be made by the surviving spouse with respect to both himself and the decedent if no return for the taxable year has been made by the decedent, no executor or administrator has been appointed, and no executor or administrator is appointed before the last day prescribed by law for filing the return of the surviving spouse. If an executor or administrator of the decedent is appointed after the making of the joint return by the surviving spouse, the executor or administrator may disaffirm such joint return by making, within 1 year after the last day prescribed by law for filing the return of the surviving spouse, a separate return for the taxable year of the decedent with respect to which the joint return was made, in which case the return made by the survivor shall constitute his separate return;

Individuals who file a joint return are not aware of ***Section 6015(d)(3).*** It provides that if a joint return is made, the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several.

If there were an IRS "Miranda Warning," it would state that before you sign a Joint Tax Return be advised: Each taxpayer who signed the joint return is liable for the full amount of taxes, interest and penalties arising from the jointly filed tax return and if your spouse is discharged of this liability in bankruptcy you, the other person, who signed the joint return or consented to the electronic filing, is liable for the entire deficiency. Additionally, the IRS may pursue either you or your spouse individually for the entire deficiency in its collection process. If your former spouse declares bankruptcy and is discharged from both the tax liability and liability under your divorce decree, you stand alone and the entire liability is yours without recourse.

Historically, we have seen that in business transactions especially real estate investments, the investors failed to understand the meaning of joint and several liability. Thus, it is understandable that couples who file joint returns do not understand the fact that they are jointly and severely liable.

III. JOINT RETURNS - RELIEF FROM JOINT AND SEVERAL LIABILITY

Section 6015. **Relief from Joint and Several Liability on joint returns**

A. ***Section 6015*** provides three (3) possible opportunities for a taxpayer to be relieved of joint and several liability. ***Section 6015(b)*** relief is available to <u>all</u> joint filers, ***Section 6015(c)*** is available for joint filers who are now divorced or separate taxpayers. If the joint filers cannot meet the threshold requirements of ***Section 6015(b) or (c)*** then ***Section 6015(f)*** Fact and Circumstances may be available. Equitable Relief through the prism of IRS procedures or through appeal to the Tax Court is the last resort.

1. **In General**

a) an individual who has made a joint return may elect to seek relief under the procedures prescribed under subsection (b), and

b) if such individual is eligible to elect the application of subsection,

c) such individual may, in addition to any election under paragraph (1), elect to limit such individual's liability for any deficiency with respect to such joint return in the manner prescribed under subsection (c).

Any determination under this section shall be made without regard to community property laws.

2. **Definitions.** For clarity I will use the definitions set out in the regulations at ***Section 1-6015-1(h).***

a) <u>*Requesting Spouse*</u> is an individual who filed a joint return and requests relief as an innocent spouse.

b) <u>*Non-Requesting Spouse*</u> is the individual with whom the requesting spouse filed the joint return for the year for which relief from liability is sought.

Three (3) Possible Approaches for Relief: Each Approach Sets Forth Conditions All of Which Must Be Met.

IV. *FIRST:* SECTION 6015 (B) FOR RELIEF FROM LIABILITY APPLICABLE TO ALL JOINT FILERS

A. ***Section 6015(b)*** sets forth Five (5) conditions. It states: Under procedures prescribed by the Secretary, if—

1. a joint return has been made for a taxable year,

2. on such return there is an understatement of tax attributable to erroneous items of one individual "Non-Requesting Spouse" filing the joint return; and

3. the other individual "Requesting Spouse" filing the joint return establishes that in signing the return, he or she did not know, and had no reason to know, that there was such understatement, even though a reasonable person in similar circumstances should have known.

a) Further guidance IRS position, see ***Section 1.6015 – 2(c).***

b) ***Section 6015(b)(2)***. If an individual who but for ***Section (b) (1) (c)*** "reason to know" establishes in signing the return that he or she did not know or have reason to know the extent of such understatement to the portion of the understatement that taxpayer did not know or have reason to know.

c) ***Section 1.605-2(e)(1)*** provides a practical example where no knowledge of husband embezzled funds. Other examples might include withdrawals from an IRA, income from exercise of stock options, compensation or bonuses deposited into non-requesting spouse personal account.

4. taking into account all the facts and circumstances, it is inequitable to hold the "requesting spouse" liable for the deficiency in tax for such taxable year attributable to such understatement.

a) ***Section 1.6015-2(d)*** The Regulation,*"A Significant benefit is any benefit in excess of normal support. Evidence of direct or indirect may consist of transfers of property or rights to property, including transfers that may be received several years after the year of the understatement".* Transfers of property rights. See ***Rev. Proc. 2013-34, 4.04 e.***

b) This regulation notes that if the requesting spouse received a life insurance check and premiums were paid using funds traceable to omitted gross income, the insurance proceeds are considered as received by requesting spouse.

c) The most troubling issue for our client who is now divorced will be amount received in a property settlement incident to divorce. *Cutler v. Commissioner T.C. Memo. 2013-119 (2013).* Requesting Spouse received two (2) dental practices, the marital home and two (2) parcels of land which the Service contended represented "a significant benefit". The court looked at the underlying financial condition of each asset, very marginal profit in the dental practices, real property in foreclosure. What is important is that if there has been a divorce and property settlement, this is going to be an issue for the requesting spouse.

d) In *Pullins v. Commission 136 T.C. No. 20 (2011)* in considering significant benefit, the Court noted requesting spouse receipt of one-half proceeds from sale of their home would have been significantly less if their tax liability had been paid.

e) *Marzullo v. Commissioner 2013-123 (2013)* requesting spouse and her husband owned a drug store, her husband, a pharmacist, requesting spouse handled business accounts. Income used to support family and business and not to pay taxes. At the death of the husband, requesting spouse received all of the interest in the business which was the owner of a life insurance policy for $1,300,000.00 on the life of decedent, non-requesting spouse. The receipt of interest in the business was a significant benefit.

f) *Karam v. Commissioner 2011-230 (2011).* Income from Dr. Karam's dental practice paid for what the court characterized as expensive private elementary and high school education for their four children even though public school children in requesting spouse community scored well on tests.

g) The facts and circumstances are extremely important. Additional cases and discussion are provided in Article VI C. of this Memorandum.

5. the individual "requesting spouse" elects (in such form as the Secretary may prescribe) the benefits of this subsection not later than the date which is 2 years after the date the Secretary has begun collection activities with respect to the individual making the election.

If all of these requirements are met, then the individual "requesting spouse" shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent such liability is attributable to such understatement.

B. If requesting spouse meets all of the requirements except for ***Section 6015(b)(1)(c)*** did not know or have reason to know for a portion of the liability but not all, the requesting spouse may be relieved of taxes, interest and penalties attributable to portions (items) he or she did not know or have reason to know. ***Section 6015(b)(2).***

1. Key factors applicable to ***Section 6015(b), 6015(c)***, and ***Section 6015(f)***

a) *Actual Knowledge or Reason to Know*

(i) IRS has the burden of proof—the preponderance of the evidence. ***Section 60153(c)(i)***

(ii) Focus omitted income or deduction or credit

(a) Omitted income

(b) Knowledge of receipt of income

(c) Knowledge non-requesting spouse has other income but requesting spouse does not have actual knowledge of receipt.

b) *Deduction Credit*

(i) Knowledge of facts that made the item not allowable as a credit or deduction

(ii) Fictitious or inflated deduction. Actual knowledge that expenditure not incurred or not incurred to extent claimed

c) *Partial knowledge allocation*

d) *Knowledge of source of an erroneous item is not sufficient to prove actual knowledge.*

e) *Factors supporting actual knowledge*

i) Requesting spouse deliberate effort to avoid learning about the item

ii) Jointly owned property

2. In *Reilly-Casey v. Commissioner, T.C. Memo 2013-292 (12/30/13)***,** the Judge did not accept the taxpayer's asserted lack of reason to know of understatements because she did not sign joint return and declared that was "unbelievable." Given taxpayer's level of sophistication and professional experience, she should have known or inquired about understatement.

3. *Santa v. Commissioner, T.C. Memo 2013-178* ***(relief under §6015(c))*** allowed where, while a bank account was jointly owned and the taxpayer maintained a separate account, the requesting spouse had limited or no use of the joint account into which the spouse deposited profit-sharing withdrawal of which the requesting spouse was not aware.

4. The most frequently cited case involving erroneous deduction is *Price v. Comr., 887 F.2d 959 (9th Cir. 1989).* The case involved an erroneous deduction for mining exploration and development expenses arising from the husband's gold mine investment. The opinion forcused on whether the spouse was "so intimately involved with the investment that she knew virtually all of the facts of the transaction underlying the deduction." The Court pointed out the following factors:

a) The wife had limited involvement in the financial affairs of the marriage. The couple had separate checking accounts for investments which the husband held and for household expenses which the wife paid;

b) There were no unusually lavish expenditures when compared to past levels of income and standard of living; and

c) The husband misled the wife by assuring her that the CPA would not have improperly claimed a deduction.

5. In *Bokum v. Comr, 94 T.C. 126 (1990)* the erroneous claim of a basis deduction offset the amount of a dividend distribution. The wife seeking innocent spouse relief knew of the transaction giving rise to the dividend, the amount of the dividend distribution, and the large basis deduction reducing the reported amount on the return. The Tax Court found that she knew or should have known of the deduction giving rise to the omission. It held that a taxpayer seeking relief from joint and severed liability must establish that she was unaware of the circumstances reported in error on the return and not merely that she was unaware of the tax consequences. The size of the basis subtraction and the return preparer's failure to sign the return should have placed the wife on notice to inquire further.

6. In the Fifth Court's *Reser v. Comr., 112 F.3d 1258 (5th Cir. 1997)***,** the requesting spouse did not have reason to know that S Corporation losses were overstated or have duty to make further investigation because the husband erroneously claimed basis in S Corp stock based on loans from bank to corporation.

7. More recently, in *Alexander v. Commissioner, T.C. Memo 2013-203* a non-requesting spouse participated in Offshore Employee Leasing (OEL). The non-requesting spouse, a doctor, received fees for services from offshore company balance of income deposited in offshore accounts. Requesting spouse attended investment seminar in Bahamas and was Trustee of one of the accounts.

V. *SECOND:* 6015(C) LIMITED TO TAXPAYERS NO LONGER MARRIED OR TAXPAYERS LEGALLY SEPARATED OR NOT LIVING TOGETHER

A. The requirements for subsection are:

1. An individual shall only be eligible to elect the application of this subsection if—

a) at the time such election is filed, such individual is no longer married to, or is legally separated from the individual with whom such individual filed the joint return to which the election relates, or

b) such individual was not a member of the same household as the individual with whom such joint return was filed at any time during the 12-month period ending on the date such election is filed.

2. *Certain Taxpayers Ineligible to Elect.* If the Secretary demonstrates that assets were transferred between individuals filing a joint return as part of a fraudulent scheme by such individuals, an election under this subsection by either individual shall be invalid and ***Section 6013(d)(3)*** shall apply to the joint return.

3. *Time For Election.* An election under this subsection for any taxable year may be made at any time after a deficiency for such year is asserted but not later than 2 years after the

date on which the Secretary has begun collection activities with respect to the individual making the election.

4. *Election Not Valid With Respect To Certain Deficiencies.* If the Secretary demonstrates that an individual making an election under this subsection had actual knowledge, at the time such individual signed the return, of any item giving rise to a deficiency (or portion thereof) which is not allocable to such individual under subsection (d), such election shall not apply to such deficiency (or portion). This subparagraph shall not apply where the individual with actual knowledge establishes that such individual signed the return under duress.

5. ***Section 6015 (c) (4)*** is also applicable. The requesting spouse does not receive relief from deficiency equal to the value of any disqualified asset transferred to the requesting spouse. Disqualified asset is broadly defined as property or property right transferred for the principal purpose of tax avoidance or payment of tax.

B. *Allocation.* ***Section 6015 (c) (4)*** Challenge: if you meet the conditions of Section 6015 (c), you must address the allocation of the deficiency.

1. For purposes of ***subsection (c) of 6015,*** if you meet the conditions - then you must deal with allocation of the deficiency:

a) Allocable in the manner as if the individuals had filed separate returns (except paragraph (4)). If item disallowed because separate return is filed, disregard liability of a child of taxpayer included in a joint return.

b) Guidance for Allocation extensively addressed in regulations with practical examples. ***Section 1.6015-3.***

(1) The portion of the deficiency is increased by the amount of the disqualified asset (any property or right in property) valued at its fair market value at date of transfer and asset transferred twelve months before thirty-day letter or notice of deficiency. Eight examples are provided in the regulations. ***Section 1-6015-3(c) (4).***

(2) Erroneous items of income are allocated to the spouse who was the source of the income. ***Section 1.6015-3(c) (2).***

(3) Erroneous deduction items related to the business or investment are allocated to the spouse who owned the business or investment. ***Section 1-6015-3(d)(2)iv.*** The Tax Court has given careful consideration and considerable weight in numerous cases to the role of the requesting spouse in the management of the business or investment.

(4) Once the allocation is determined the regulations provide the applicable formula for computation of the tax. ***Section 1.6015-43(d)(4).***

(5) Guidance for allocation for a deficiency from two or more erroneous items subject to different tax rates is given at ***Section 1.6015-3(d)(6).***

2. Exception where the spouse benefits

a) Erroneous items of income are allowable to the spouse who was the source of the income. Items of business or investment income are allocated to spouse who owned the business or investment. If both owned the business, generally allocated in proportion to each spouse's interest.

b) Erroneous Deductions are allocated to the person who owned the business investment. If both spouses owned the business or investment, erroneous deductions are generally allocated between the spouses in proportion to the business interests.

3. ***Section 1.6015-1(c).*** In determining whether relief is available under ***Section 1.6015-2, 1.6015-3 or 1.6015-4,*** items of income, credits and deductions are generally allocated to the spouses without regard to the operation of community property laws.

VI. *THIRD: 6015(F) EQUITABLE RELIEF: FINAL OPTION*

A. *Overview.* If relief is not available to a requesting spouse under the above ***Section 6015(b)***, the person seeking innocent spouse status has one final hope, Equitable Relief under ***Section 6015(f)***. Equitable relief must meet seven (7) threshold conditions prescribed by the Secretary. For the past decade, the applicable Revenue Procedure was ***Rev. Proc. 2003-61, 2003-2 C.B. 296.*** In 2012, the IRS issued ***Notice 2012-8, 2012 -4 I.R.B. 309 1/13/2012*** noting that the number of cases under Section 6012 (f) has "grown significantly" and this notice indicated that there would be additional guidance to include financial control by the non-requesting spouse when a requesting spouse has been abused by the non-requesting spouse.

Section 3 of ***Rev. Proc. 2013-34*** set out the significant changes:

Greater deference to the presence of abuse in other factors can negate presence in certain factors.

If the requesting spouse meets all seven (7) conditions, then the IRS will review the facts and circumstances applying seven factors.

B. *Threshold Conditions for Equitable Relief*

Under ***Rev. Proc. 2013-34***, which is effective for requests for relief filed on or after September 16, 2013 and for requests pending on September 16, 2013, All seven (7) the following threshold conditions must be met to obtain equitable relief under ***Section 6015(f)***, and conditions (3 through 7) must be met if the requesting spouse is seeking relief by operational community property laws pursuant to ***Section 66(c) Rev. Proc 2013-34, 4.01.*** There is a very important question which is, what is the full scope of the application of ***Rev. Proc. 2013-34?*** Does it apply to ***Section 6015(f)*** or are the factors set out in it also applicable to the provisions of ***Sections 6015(b) and 6015(c)?***

1) *Joint Return Signed or Electronically Filed*. The individual must have made a joint return for the tax year for which relief is sought.

2) *Remedy of Final Resort.* Relief must not be available to the individual under ***Section 6015(b)*** or ***Section 6015(c).***

3) *Claim for Relief Must Be Timely Filed.* The individual must apply for relief within the period of limitations on collection under ***Section 6502*** (generally 10 years) or if a credit or refund is sought, within the period of limitations on credits or refunds under ***Section 6511*** (generally two or three years).

4) *Fraudulent Scheme.* No assets were transferred between the individuals filing the joint return as part of a fraudulent scheme.

5) *Transfer of Disqualified Assets*. There were no disqualified assets, as defined by ***Section 6015(c)(4)(B)***, transferred to the individual by the non-requesting spouse. If any such assets were transferred, the individual may still seek relief to the extent that the liability exceeds the value of those disqualified assets. However, if the requesting spouse was abused or the non-requesting spouse maintained control over the household finances by restricting the requesting spouse's access to financial information, the requesting spouse may still be eligible for relief. Additionally, the requesting spouse may still be eligible if the requesting spouse did not have actual knowledge that disqualified assets were transferred.

6) *Participation in filing Fraudulent Return.* The individual did not knowingly participate in the filing of a fraudulent joint return.

7) *Tax Liability Attributable to Other Spouse*. The income tax liability from which the individual seeks relief generally is attributable (in full or in part) to an item of the non-requesting spouse or an underpayment resulting from the non-requesting spouse's income. If the liability is partially attributable to the requesting spouse, relief is only available for the portion attributable to the non-requesting spouse. The following exceptions apply:

a) If an item is attributable or partially attributable to the individual solely due to the operation of community property law, it will be treated as attributable or partially attributable to the non-requesting spouse.

b) The presumption that an item titled in the individual’s name is attributable to him or her is rebuttable.

c) If the individual did not know, and had no reason to know, that funds intended for the payment of tax were misappropriated by the non-requesting spouse for that spouse's benefit, the IRS will consider granting equitable relief although the underpayment may be attributable in part or in full to an item of the individual, but only to the extent that the funds intended for the payment of tax were taken by the non-requesting spouse.

d) If the individual establishes that there was abuse (not amounting to duress) before the return was signed, and that, because of the prior abuse, the requesting spouse did not challenge the treatment of any items on the return or question the payment of any balance due reported on the return for fear that the non-requesting spouse would retaliate, the IRS will consider granting equitable relief.

e) If the item giving rise to the deficiency or understatement is attributable to the requesting spouse, the IRS may grant relief if the requesting spouse shows that the erroneous item was caused by the non-requesting spouse's fraud.

C. *Factors Bearing Upon the Grant of Equitable Relief*

If all of the seven (7) threshold conditions are met for ***Section 6015(f)*** or conditions 3 through 7 are met for ***Section 66(c)***, the IRS will consider the facts and circumstances through the prism of list of factors to determine whether to grant equitable relief. No one factor is determinative. In determining whether to grant relief, the IRS will weigh all facts and circumstances and pertinent factors, including those discussed below. Factors are classified as positive, negative or neutral. Even the classification of neutral or positive or negative may vary. In most of the reported tax cases, where the seven conditions have been met, the Tax Court counts the positive, negative and neutral factors. If the positive number is greater than the negative number, the requesting spouse prevails. The relevant factors are:

1. Marital Status.

Whether the requesting spouse is divorced or separated (legally separated or merely living apart) from the non-requesting spouse is a relevant factor. A temporary absence due to incarceration, illness, business, vacation, military service, or education does not constitute separation for purposes of the relevant factors list if it can be reasonably expected that the absent spouse will return to the home and the home is maintained in anticipation of the return. Widow or Widower - requesting spouse not an heir of the estate that has sufficient assets to pay tax.

Classification: Positive or Negative

2. Economic Hardship

Whether the requesting spouse would suffer economic hardship if the IRS does not grant relief is a relevant factor. Economic hardship occurs if denial of relief will cause an individual taxpayer to be unable to pay her reasonable basic living expenses. ***Treas. Reg. 6343-1(b)(4)***

What is important in determining the requesting spouse's reasonable basic living expense is that the Service may look not only to current income and expenses, but also at the requesting spouse's assets. Requesting spouses have the burden of proof. *Alt v. Commissioner, 119 T.C. 310. (2002); Henson v Commission T. C. Memo. 2012-288; 104 T.C.M. (CCH) 441, T.C. M. (RIA) 2012-288, 2012 RIA.* Engineer with considerable compensation and other assets did not meet his burden. ***Henson*** case discusses this factor and cites a number of applicable cases.

Classification: Positive or Neutral

3. Knowledge or Reason to Know

(a) Understand Requesting Spouse knew or had reason to know.

(b) Underpayment. Requesting Spouse believed return was filed. Did the requesting spouse know or have reason to know that spouse would not or could not pay the tax at the time or a reasonable time? Spousal abuse or non-requesting spouse maintained control of household finances by restricting spouse's access to financial information. The same cases and facts discussed in Article IV of this paper are applicable.

Classification: Positive or Negative

4. Non-requesting Spouse's Legal Obligation

Whether the non-requesting spouse had a legal obligation to pay the outstanding income tax liability under a divorce decree or similar decree or agreement is a relevant factor. If the non-requesting spouse has the sole legal obligation to pay the tax liability, this is a favorable factor. When the requesting spouse has the sole legal obligation, the factor is negative. In other instances, this factor is generally neutral if condition not met.

Failure to meet test yields a neutral classification.

Classification: Positive or Neutral

5. Significant Benefit

Whether the requesting spouse received significant benefit, beyond normal support, from the unpaid income tax liability or from an item giving rise to the deficiency is a relevant factor. The standard for significant benefit involves consideration of all of the facts and circumstances, as described in ***Regs. §1.6015-2(d)***.

If understatement is small and neither received significant benefit, the classification is neutral.

Classification: Positive or Negative

6. Compliance with Income Tax Laws

(a) *Income Tax Compliance of Requesting Spouse* following years for which relief is sought. If continued to file joint returns after - Neutral. If joint return non compliant, the classification is negative.

Divorced requesting spouse must be compliant. If not, classification will be negative.

If factors are not present - classification is neutral.

Classification: Positive, Negative, or possible Neutral

7. Mental or Physical Health

Poor mental or physical health of the requesting spouse at the time he or she signed the return or at the time he or she requested relief may weigh in favor of the grant of relief to the requesting spouse. When weighing this factor, the IRS considers the nature, extent and duration of the illness.

Classification is positive if poor mental health or physical health is otherwise neutral.

VII. GUIDANCE FOR SPOUSAL ABUSE DETERMINATION

A. History in Revenue Procedures

Abuse has been a factor that the IRS considered, but there was little guidance until ***Rev. Proc. 2013-34***. ***Rev. Proc. 2003-61*** simply provided that the presence of abuse may mitigate a requesting spouse's knowledge or reason to know. There have been two situations where there was creditable evidence of physical abuse or extreme emotional abuse. The first is in the context of ***6015(c)(3)(C).*** In subsection (C), the election for a divorced or separated requesting spouse was not valid if the IRS could show that with respect to certain deficiencies, the non consenting spouse had actual knowledge and in the application. The second was in determination of whether the requesting spouse met the seventh condition of ***Section 6015(f)*** that "the income tax liability from which the requesting spouse seeks relief is attributable or partially attributable to the requesting spouse solely due to the operation of community property."

With the acknowledgement in ***Rev. Proc. 2013-34*** that abuse comes in many forms and should be considered, the question is if the non consenting spouse can provide a well documented case regarding significant abuse, will the Tax Court consider abuse in applying the facts and circumstances to other provisions in ***Section 6015(b)(1)(C)*** or take into consideration all of the facts and circumstances that suggest that it is inequitable to hold the other individual liable for the deficiency in tax ***6015(b)(1)(D)*** the requesting spouse did know or have reason to know. This becomes a very important question for while abuse may be given broader consideration in ***6015(f),*** a consenting spouse is not entitled to relief under section ***6015(f)*** unless the consenting spouse does not qualify for either the provisions of ***6015(b)*** or ***6015(c)***. How much consideration, if any, might be given to the plight of an abused spouse in applying the apportionment of relief for the non consenting spouse who meets the qualifications under ***Section 6015(b)*** or meets the requirements under ***Section 6015(c)*** and now must deal with the allocation rules. I believe this becomes a very important issue where the parties who filed the joint return had substantial assets and in a divorce settlement where the consenting spouse received a substantial monetary settlement. In many of the divorce cases, the consenting spouse may have received a substantial cash settlement, the family homestead in Tarrytown or Westlake with a modest mortgage and the non consenting spouse received the company business,

investment real estate, but little cash. The challenge is exacerbated by the fact that the cash portion may be more than the IRS conferee or Revenue Officer making the original determination will earn in their lifetimes.

The cases over the past decade provide mixed guidance as to what actions by the non-requesting spouse gave rise to abuse. There is one case that noted while the police had been called to the residence on two occasions, the requesting spouse's petition for divorce did not plead abuse. I am not going to cite this case for I feel it's an embarrassment to the tax court.

Rev. Proc. 2013-34 is much more helpful and provides guidance for a requesting spouse to ascertain what is abuse and expands where abuse may be considered. Provides in .03 (c) (iv) not only indicates that abuse may influence some of the seven factors and more importantly, it describes many of the aspects of abuse and broadens the definition beyond physical abuse. It states:

> ***"Abuse comes in many forms and includes physical, psychological, sexual or emotional abuse, including efforts to control, isolate, humiliate and intimidate the requesting spouse, or to undermine the requesting spouse's ability to reason independently and be able to do what is required under the tax laws."***

Rev. Proc. 2013-34 states that abuse may be considered in the application of the seventh condition where relief would be partially attributable to the requesting spouse. This is a very important for in many of the reported tax court cases, the requesting spouse failed to obtain relief because of the inability to meet the requirements of the seventh condition.

The Tax Court cases have not addressed the facts in the context of patterns of conduct and there is not one reported case in which there is a reference to testimony from a therapist or psychiatrist. This is likely attributable to the fact that legal counsel may have not worked with their client to prepare an affidavit detailing the patterns of conduct of the non-requesting spouse that were abusive and which impeded the requesting spouse to question aspects of their joint returns. Where the requesting spouse has been unsuccessful, one of the key factors has been the lack of corroboration and third party documentation.

B. Battered Woman Syndrome

Our colleagues who practice criminal law are much more aware of the issue of spousal abuse for it is often a very significant issue in domestic violence cases and particularly in cases in which the spouse accused of murdering his or her spouse puts forth the defense of an abused spouse. In trying to determine what documentation is going to be effective in meeting the facts and circumstances test for a determination that supports physical and psychological abuse that reaches the level of spouse abuse, there is a considerable amount of detail in criminal law where an abused spouse has taken the life of the abusive spouse. Many criminal law attorneys historically presented evidence in what is referred to as the Battered Woman Syndrome.

Dr. Lenore Walker raised our consciousness of the plight of the abused spouse in her ground breaking book *The Battered Woman.* In her book, Dr. Walker provided considerable documented research identifying the patterns of behavior exhibited by battered women. This theory was defined as the Battered Woman Syndrome and it included three typical phases. The relationship and interaction begins with "tension building incident." In this phase, there is verbal bickering and increasing tension building between the husband and wife. In the second phase, the relationship erupts into an acute battering incident in which the batterer explodes into uncontrollable and violent rage and there is physical contact injuring the innocent spouse. In the third phase, the couple enters into a loving contrition state, in which the batterer expresses complete regret and continually apologies and promises to change his or her future behavior. These phases are repeated and the victim is reduced to a constant state of fear and anxiety indentified as cumulative terror. If non-requesting spouse has physically injured the requesting spouse in a single incident, and thereafter verbally abuses the requesting spouse, does this quality as abuse?

Psychologist Martin Seligman in his research with laboratory dogs exposed to electric shock learned that they become helpless and thus fail to escape even when provided with the opportunity to do so. This explains that after repeated abuse, the abused spouse simply is unable to control or escape their partner's violence.

While considerable credit should be given to Dr. Walker and her raising awareness, today the term Battered Women Syndrome does not adequately reflect the breath or nature of the scientific knowledge currently available concerning battering and its effects. In reviewing the reported cases where the requesting spouse is asserting abuse, there is no mention of family of origin issues. Today there is considerable accepted research that family of origin issues have a significant impact on adult behavior.

C. Documenting Spousal Abuse

1. *Family of Origin Issues.* Working with the requesting spouse in documenting the abuse that impeded the ability to question the actions of the non-requesting spouse requires compassion and tact. I believe the threshold inquiry begins with family of origin issues. Therapists often recite five (5) primary problematic situations occurring earlier in life that create patterns that are carried through adulthood. These situations include:

- Childhood trauma (physical, sexual or emotional abuse)
- Critical or harsh parenting styles in childhood
- Rejecting or dismissing parenting styles in childhood
- Living in a chaotic, fear-based environment in childhood
- Witnessing a volatile, high-conflict relationship between your parents

If there are significant family of origin issues and they are addressed in one or more affidavits, detailing facts and circumstances, they provide the basis for understanding the linkage between the emotional trauma in childhood and the disposition of the requesting spouse to placing herself or himself into a similar situation in the choice of a spouse. The outrageous conduct of the non consenting spouse and its emotionally crippling impact on the requesting

spouse become much better understood. The tying of the original family of origin problematic facts and circumstance with the abusive conduct also supports the possible severe emotional depression, anxiety and fear that are now considered in the seventh factor in section 6015 (f) as set out in Rev. Proc. 2013-34.

2. *Identifying the Patterns of Conduct.* ***Rev. Proc. 2013-34*** has now acknowledged that abuse come in many forms and the requesting spouse contention of what patterns of conduct existed needs to be fully set out. If the pattern of conduct was physical abuse, was the cycle similar to the Battered Woman Syndrome and if so, the pattern should be detailed. This same cycle may exist but instead of a physical confrontation, the non-requesting spouse yells, uses abusive language and leaves or totally disconnects and does not talk for extended periods of time. The actions of a controlling spouse can be detailed as well as how the requesting spouse was admonished for not meeting expectations and directives. Constant belittling and intimidation need to be very carefully described. Isolation takes many forms from not allowing non-requesting spouse and children to have contact with grandparents and preventing or thwarting relationships with possible friends and other sources of support to repeatedly volunteering for service in Iraq, Afghanistan, etc. and leaving the family in Anchorage, Alaska or Ft. Benning, Georgia.

3. Sensitivity & Professional Responsibility. Raising these issues require considerable skill and compassion. We are lawyers and not trained therapists. If the client has a therapist, the lead in question can be very opened ended. Have you ever worked on family of origin issues? If the client has not been in therapy and has not done any interior work, this can be a very challenging issue to properly raise. I have footnoted some books[1] that one might encourage a client to read. For some of us, we can share our family history which provides an indication that our childhoods were less than perfect. If you experienced one or more of these problematic situations, they are important for they begin to explain the ongoing abuse. The lack of self worth (I'm not good enough), depression, and addictions often begin in childhood. Encourage the client to write about these aspects of his or her childhood and include specific incidents if possible. *"My father would come home on Friday evenings after drinking with the men at work. I remember several occasions when he hit my mother. One evening he pushed me in rage and I fell over the coffee table."* If the client has worked with a therapist, participated in group, and/or attended workshops, this information is helpful. Getting corroboration from the clients' therapist can be very helpful and this can be very challenging in itself.

This can become very challenging and emotionally devastating for the client. As counsel, you have encouraged your client to discuss with siblings some of the family of origin issues. What if the client confronts a family member regarding the issues of suspected sexual abuse and learns that he or she was abused? What if we now believe our client is experiencing severe emotional depression? What is our responsibility to encourage the client to get some

[1] The following is a list of books on family of origin issues: **Trauma and its Wake**, By: Charles R. Figley; **Treating Family of Origin Problems**, **A Cognitive Approach**, By: Richard C. Bedrosian; **Trauma and Recovery**, By: Judith Herman; **Courage to Heal**, By: Ellen Bass; **Systemic Treatment of Families Who Abuse**, By: Elian Gil; **Family Ties that Bind**, By: Ronald Richardson; **Family of Origin Therapy**, **An Intergenerational Approach**, By: James L. Framo.

professional help? Are we off base in asking if the client would consider talking with someone in his or her faith community regarding these matters?

4. *Developing Documentation.* Having examined family of origin issues and possibly tied them into the patterns of conduct a reasonable sensitive person would consider to be abuse, the next challenge is developing third party documentation. Is there a neighbor who would provide an affidavit? *"Janet confided in me about Carl striking her, pushing her against the refrigerator."* A former employee may be able to address alcohol or substance abuse, infidelity, or how the non-requesting spouse isolated the requesting spouse. The neighbor's affidavit that recalls the Friday evening Janet packed the car and the kids and went to her parents for she was afraid of Carl is most helpful. Where there is no physical abuse, third party documentation describing the non-requesting spouse is essential.

5. *Case Law Addressing Abuse*. There are several cases that address abuse for it was an important factor under ***Rev. Proc. 2003-61, Sec. 4.01(7)(d).*** *Niehiser v. Commissioner, T.C. Memo. 2008-135* was the first case where the Tax Court acknowledged that abuse for purposes of ***Rev. Proc. 2003-61*** could be physical or solely psychological. The guidance is very clear. There must be substantiation, or at least specificity, regarding the claimed abuse: generalized claims of physical or emotional abuse are insufficient.

Further guidance for non-physical abuse is provided in *Pugsley v. Commissioner, T.C Memo. 2010-255****,*** "Non-physical abuse will weigh in favor of relief only if it is severe enough to incapacitate a requesting spouse in the same manner he or she would be incapacitated by physical abuse." The *Thomassen v. Commissioner T.C. Memo 2011-88 (2011)* is most helpful. In this case the Court determined that there was sufficient evidence of psychological abuse to determine that the requesting spouse was abused and therefore the seventh condition under ***Section 6015(f)*** was met notwithstanding that the deficiency may be attributable in full to an item of the requesting spouse. There was third party testimony collaborating Dr. Thomassen's propensity to inflict psychological abuse, the impact on one of the children was noted, a specific incident witnessed by friends was stated, and finally Mrs. Thomassen sought counsel from her priest who counseled perseverance.

The fact that the non-requesting spouse was an alcoholic is not sufficient to support a finding of abuse. *Hudgins v. Commissioner T.C. memo 2012-260 (2012)****.***

There is one reported case when the requesting spouse prevailed on the issue of abuse without third party corroboration. *Drayer v. Commissioner, T.C. Memo. 2010-257 (2010*). In its opinion, the court stated: Petitioner credibly testified that Mr. Drayer would often get very angry, particularly in the context of discussions about finances and taxes. Petitioner provided specific examples of angry outbursts, including a time when Mr. Drayer physically threatened to hit her and specific instances of broken items.

Mr. Drayer told petitioner that he had intended to commit suicide after one particularly terrible fight. Petitioner testified that Mr. Drayer regularly called her specified derogatory names and publicly humiliated her. She also testified that he regularly drank to excess and smoked marijuana.

This case is helpful in providing insight into the types of patterns of conduct that a court will consider favorably in its decision process.

The Drayer case underscores the importance of requesting spouse statement, affidavit or testimony at trial which must be very clear in describing the patterns of conduct that gave rise to fear and submission. In addition to the patterns of conduct, specific events that can be corroborated are very important. If the requesting spouse sought help from family, friends, therapist or clergy and the person who recalls this fact will provide a statement, the assertion of abuse is significantly strengthened. Impact on children will be given credence by the Tax Court.

The challenge is that the dominant non-requesting spouse is often financially successful, well respected and sometimes feared. Frankly, good well-intended people simply are reluctant to get involved.

VIII. ADDITIONAL FACTORS

1. An additional factor that some Tax Court cases have considered is the dominant spouse's use of alcohol and the conduct of the dominant spouse, when under the influence, on the mental and physical health of requesting spouse. The initial question may be when you and your spouse entertained, is there someone who might provide an affidavit regarding the non-requesting spouse's abuse of alcohol? A review of credit card expenditures may provide some documentation such as extensive charges at well known gentlemen's clubs? Documentation of alcohol related incidents with the judicial system are generally available. The key is to tie the alcohol addiction to the conduct of the non-requesting spouse that was abusive and significantly impacted the requesting spouse. In *Haggerty v. Commissioner*, the Tax Court was very clear that the fact that the deceased husband was a large imposing man and an alcoholic did not constitute abuse.

2. Where the parties are divorced and the divorce proceedings use extremely contentions, there may be helpful documentation. The deposition of the dominant spouse may be particularly helpful. Did the dominant spouse have a personal credit and what do the credit and charges reveal? Large charges at Gentlemen's Clubs document emotional abandonment, disregard for spouse and children. This is an area that helps indicate the lack of control by the requesting spouse.

3. *Physical and Mental Health.* The requesting spouse's mental and physical health are important and again documentation is essential. This is a challenging area. My experience is that the most effective approach with the requesting spouse's therapist is to ask for a meeting with the therapist and the client. This provides the opportunity for sharing of issues and determining whether there are facts that support abuse and the willingness of the therapist to share the facts. Bring a global release that will provide full protection for the narrative description of confidential patient information. Simply asking the therapist for statement or having a brief discussion on the phone is not going to provide the detailed affidavit that will support the requesting spouse's position.

4. *Support from Non-Requesting Spouse.* An affidavit from the non-requesting spouse will be most helpful. If the requesting spouse is contemplating bankruptcy, there is no economic downside. Would the non-requesting spouse be willing to acknowledge their issues: I have problems with anger management; after our divorce, I begin attending AA meetings; I made all of the financial decisions; I gave my spouse a household allowance; We owned stock in the business, but I was in charge; I did not discuss the tax shelter investment; I hired a CPA to prepare our tax return; I gave her the return to sign and I expected her to sign it. These types of admissions are so very helpful and his legal counsel may be the most effective entre.

IX. EXPEDITED REVIEW PROCESS

A. ***Rev. Proc. 2013-34*** provides that the service will expedite its review of the application if the requesting spouse meets three (3) conditions:

1. *Marital Status.* Is no longer married to the non-requesting spouse as set forth in ***Section 4.03(2)(a)***;

2. *Economic Hardship.* Would suffer economic hardship if relief were not granted as set forth in ***Section 4.03(2)(b)***; and

3. *Knowledge or reason to know.* ***Section 6015(f)*** cases. Did not know or have reason to know that there was an understatement or deficiency on the joint income tax return, as set forth in ***Section 4.03(2)(i)***, or did not know or have reason to know that the non-requesting spouse would not or could not pay the underpayment of tax reported on the joint income tax return, as set forth in ***Section 4.03(2)(c)(ii).*** If the non-requesting spouse abuses the requesting spouse or maintained control over the household finances by restricting the requesting spouse's access to financial information, and because of the abuse or financial control, the requesting spouse was not able to challenge the treatment of any items on the joint return, or to question the payment of the taxes reported as due on the joint return or challenge the non-requesting spouse's assurance regarding payment of the taxes for fear of the non-requesting spouse's retaliation, then the abuse or financial control will result in this factor being satisfied even if the requesting spouse knew or had reason to know of the items giving rise to the understatement or deficiency or knew or had reason to know that the non-requesting spouse would not pay the tax liability.

B. *Tax Shelter Case Issues*

The Agent rarely makes a favorable determination. The process according to IRS current correspondence is that it will "take about three (3) to six (6) months for a decision to be made".

Final Review petition to the Tax Court is due earlier than ninety (90) days from receipt of certified or registered mail to taxpayer's last known address or six (6) months after elections filed with Secretary but not later than ninety (90) days from receipt of notice.

Following a determination, taxpayer has ninety (90) days after date the IRS mails notice of final determination by certified or registered mail. If taxpayer misses date, the issue becomes

whether the IRS used "reasonable diligence." Fifth Circuit *Terrell v. Commissioner 625 F.3rd, 254 (2010).*

Taxpayer prevailed: Finding that the IRS failed to take any steps to determine Terrell's correct address after receiving returned mail, the determination was made that the IRS failed to exercise reasonable diligence. Given the IRS notice that Terrell's address on file was no longer valid, it failed to exercise "reasonable due diligence," therefore, the court found the original notice null and void.

C. *Cases with Intervening Spouse.*

There are cases where the relationship between former spouses is very contentious and when one party seeks to be determined an innocent spouse, the other party intervenes. These cases often arise where there is unreported income attributable to the other spouse. *Pounds v. Commissioner Tax Court Memo. 2011-262* is an excellent example. The husband was solely responsible for maintaining the checking account and finances from his company and worked with a CPA. Appeals awarded review ***Section 6015 (c)***. Not communicated to Mrs. Pounds, she filed in Tax Court and her husband was interviewed. He reported that his wife had "reason to know." Under ***Section 6015 (d)*** practical effect the item that gave rise to the deficiency will be allocated in the same manner as the individual who filed a separate return ***Section 6015 (d)(3)(A)***.

Test: at the time the spouse signed the return, did they have "actual knowledge" established by the preponderance of the evidence? *Cheshire v Commissioner, 115 T.C. 183, 2000 WL 1227132 (2000), affd. 282 F.3rd. 326 (5th Cir. 2002).*

Sotuya v. Commissioner Tax Court Summary OP 2012-27 Section 6015(6) and five elements - requesting that the spouse establish in signing the return that he or she did not know or have reason to know there was an understatement. Sotuya was well educated and prepared a joint return. The separated wife submitted only one W-2. He testified he knew she performed services at several places - some as a volunteer and others for compensation. Because it was determined he had reason to know, no relief was given under ***Section 6015(6)***.

But ***Subsection 6015(c)*** allows proportionate tax relief.

Emails surfaced. but they were after returns were electronically filed. Mr. Sotuya did not have actual knowledge therefore of allocation of W-2 income to his former spouse.

Court applies a *de novo* standard and scope of review. Petition bears the burden of proof under ***Section 6015(f).*** The Courts consider guidelines from *Porter v Commission 132 T.C. 203, 210, 2009.* More recently *Hudgins v. Commissioner T.C. Memo. 2010 - 260, 104 T.C.M. (CCH) 283 T.C.M (RIA) 2012 - 260.*

X. INNOCENT SPOUSE IN THE TAX SHELTER CONTEXT.

The challenges facing counsel in representing the taxpayer who seeks relief under ***Section 6015*** or ***Section 66 (c)*** of the Internal Revenue Code is going to be much more challenging if the tax liability arises out of a tax related investment. The IRS decided to work with a special task force.

- In the shelter innocent spouse venue, there are several aspects to review and consider:
- The size of the numbers can be daunting and client needs to understand that this makes the case more challenging.
- The divorce decree and its provisions as the tax matters
- The position to take in the response to the IRS notice and settlement offer.
- What role to take if the case is contested.
- How to handle the claim, if any, against the promoter and legal counsel.
- What actions to take if the husband applies for bankruptcy.

A. *Size of the Numbers*. In reviewing a number of the tax shelter cases, it is clear that the size of the tax liability is much more significant. The issues of life style d the spouse's beneficial enjoyment need to be carefully addressed. This takes extreme tact for often the client would be much better served by downsizing in all of the apparent areas of their life. A smaller home or condo, a more conservative automobile, low key vacations support the position that the other spouse was the big spender and our client was simply a conservative steward who managed the family home and cared for the children or was actively involved in her own trade or business.

B. *The Divorce Decree*. If the parties are divorced and you are representing the spouse, the divorce decree will set out the first set of guidelines. In most cases, the husband will have the responsibility for all tax liabilities that arose prior to the divorce and the authority to handle all matters related to the tax motivated investment. If the taxpayers were a high profile family and one of the more aggressive family law lawyers participated, the rancor may still be present and getting cooperation may be most difficult. I suggest that if possible you work with counsel to get a statement from the husband as soon as practical setting out his role in the tax shelter, investment decisions, control of family business and if factual, his exclusive self appointed authority. If there are children of the marriage, one approach is to note that in light of the challenges, the only legacy the children may receive will be from the innocent spouse.

C. *Responding to IRS Settlement Offer*. The IRS will issue a letter giving the parties who filed the joint tax return the opportunity to settle within a modest time frame with a lesser penalty. This was the approach that the Service followed in the Son of Boss cases. The first challenge is whether the non-requesting spouse is willing to agree to a settlement and accept the IRS settlement offer and pay the taxes. Depending upon the nature of the assets and the merit of the investment, the non-requesting spouse may elect to contest the matter. It may be necessary to file suit simply to have time to marshal assets to pay the tax liability. We made a conscious effort to refrain from active participation and we felt it was best that our client not have a great deal of understanding of the initial investment so that if she is deposed later, she can truthfully testify that she had little, if any, knowledge of the tax related investment.

D. *Contested Matter & Review of Government's Case*. If the matter is contested, it may be a very lengthy process. I would encourage counsel to begin getting the documentation to support the requesting spouse's position as an innocent spouse. In a Son of Boss case that we have been actively involved in, the Tax Court case was delayed several years for the attorney who prepared the legal opinion was indicted, tried, sentenced to prison and then appealed his conviction. This process took place over several years. Caveat: These cases are assigned and worked on a consolidated basis and legal counsel at IRS who handles these matters is most capable.

You will want at a minimum, to review the entire discovery that the IRS has complied during its investigation. I was surprised at the detailed documentation that the IRS had assembled with all of the emails between the clients, the promoters and legal counsel. In preparing an innocent spouse case, a careful review of the government's files is essential. You need to know what documentation the Government has regarding your client's participation and their knowledge of what was transpiring. You can expect that the innocent spouse case will be assigned to a Revenue Officer in the special group that is working that particular group of tax cases and that the Revenue Officer will have complete access and knowledge of the Government's case and all supporting documentation. The review process will be extended for months.

E. *Malpractice Litigation*. If the husband is actively contesting the proposed taxes, his counsel is going to want to postpone any cause of action against the law firm and accounting firm that marketed the tax related investment. They may be able to negotiate a tolling letter for a couple of years, but counsel of the insurance carrier is going to press for closure. Filing a law suit and properly pleading causes of action will set forth facts and assertions that are inconsistent with the defense of the tax case. At some point into the process, the husband's financial situation may have worsened and bankruptcy may be in the offing. The insurance carrier through its lawyers is going to simply tell you to accept this offer or wait it out and settle for pennies on the dollar with the trustee in bankruptcy. Hopefully, your client who is equally impacted by the reliance on the legal opinion is not is a position to support a creditable claim for malpractice so the matter is very difficult and your client is going to have to settle. Caveat: the language in the settlement agreement must be carefully considered and your client is going to have to sign the settlement agreement.

F. *Non-requesting Spouse's Bankruptcy*. If the non-requesting spouse files for bankruptcy a number of difficult problems arise. First, your client as the party asserting innocent spouse status is listed as a creditor in the proceedings, but preventing discharge is not likely. Rarely the husband's actions in these matters give rise to sustainable claims of fraud. Your client is jointly and severally liable so if the non-requesting spouse is discharged, the wife is solely exposed. In one such case, we interpleaded in the bankruptcy case asking the Court to hear the innocent spouse case. The Justice Department invited counsel for both the non-requesting spouse and wife to Dallas. This was initially very productive for we had a different group of lawyers to work with and the Justice Department was serious about trying to enter into global settlement discussions. This took the matter out of the hands of the special task force group. Unfortunately, the husband did not follow through and our opportunity to negotiate a settlement was lost. Candidly, it may be that a bankruptcy is in the best interest of your client for

if your client is financially able to only pay a portion of the tax, the non-requesting spouse may file seek to have a portion of the tax liability allocated to your client. This is another reason why you need to try and get an affidavit from the non-requesting spouse early in the process.

G. *Extended Period of Time*. In one case, it has been over ten years and we are just now awaiting the Revenue Officer's determination of innocent spouse. Fortunately, the documentation with affidavits supporting various aspects of our client's position was taken at the outset of our representation. If we had waited, some of the key individuals would not have the same vivid memories of critical events. Others whose sworn affidavits would have been helpful may have died. I cannot over stress the need to get the supporting documentation as soon as possible. Medical records, copies of credit card statements, bank statements, signature cards and any other documentation is much more challenging to recover with the passage of time.

XI. Overview of Helpful Case Law

There are a very significant number of reported cases and the following is a summary of some of the cases you may find helpful on specific matters associated with the application of applicable avenues for the requesting spouse.

A. For attribution to the non-requesting spouse, look not only to how ownership is held between spouses, but also to each spouse's level of participation in the activity that gave rise to the erroneous item. ***Juell v Commissioner T.C. Memo. 2007 - 219. 94 T.C. M. (CCH) 143; RIA 2007-219, 2007 RIA.*** The husband deposited a tax refund check into his separate account rather than into a partnership account. This was the determinative factor in deciding who benefited from the tax refund.

1. *Facts and Circumstances*

a) Whether significant benefit to the spouse claiming relief.

b) Derivation fact not that a refund was received, but who benefitted from it. *Abelein v. Commissioner T.C. Memo. 2009 - 274.*

c) Receiving Spouse used refund for his or her sole benefit. *Hillman v Commissioner T.C. Memo. 1987-365.*

d) *Alexander v. C. I. R, T.C. Memo. 2013 - 203106 T.C. M. (CCH) 198, T.C.M.(RIA) 2013 - 203*

i) Husband plastic surgeon Offshore Employee Leasing (OEL). Dr. received fees for services balance after four percent (4%) fee deposited in offshore accounts. Wife attended OEL seminar in Bahamas and she was Trustee of Trust. Requesting Spouse of Innocent Spouse status failed ***Section 6015 (6) (1) (B) C and D***.

ii) *Price v. Commissioner 887 F.20, 959 (9th Cir. 1989).*

Test is whether a deduction case is different from omissions in income.

"A spouse has "reason to know" of a substantial underpayment if a reasonably prudent taxpayer in her position at the time she signed the return could be expect to know that the return contained a substantial understatement".

iii) *Alexander v. Commissioner T.C. Memo. 2013- 203*

Husband a plastic surgeon, Offshore Employee Leasing (OEL) Dr. Alexander received fees for his services, balance transferred to offshore accounts for Dr. Alexander.

B. Electronic Filing in Context of Joint Return

Zimmerman-Phillips v Commissioner No. 2298-125 (January 15, 2014). This is the first reported case that addressed the addition of the new requirement of Rev Ruling "the liability from which the requesting spouse seeks relief is attributable to an item of the non-requesting spouse." In this case, the husband filed the return electronically.

H & W are in process of obtaining a divorce and their lawyers advised them to file a joint return. A practice of several years, Mrs. Phillips placed her tax information in a file and gave it to her husband. He prepared the return. When she gave him the tax information, it did not include her W-2. Before April 15, she receives her W-2, but her husband does not respond to her phone calls, April 16 she reaches him and learns that her W-2 income has been omitted. She says that she did not sign the return and her husband replies that he filed it electronically. In August, she finally gets information from Mr. Phillips and in the Fall, she files an amended return.

A timely filed petition in Tax Court was submitted after an unfavorable determination at Appeals. The issue was the electronic return and whether husband and wife intended to file joint return. *Ziegler v Commissioner Tax Court. Memo. 2003-282.*

The taxpayer met 6 of the 7 conditions of the IRS. The taxpayer failed the seventh "income tax liability solely attributable to petitioners' income."

Judge Laro noted "We consider the Commissioners' guideline for equitable relief, we are not bound by them". *Pullins v Commissioner, 136 T.C. at 438-439.*

Mrs. Phillips knew as early as April 16 of the applicable tax year that her W-2 income was not included. Her attempt to address the matter was not sufficiently timely filing an amended return in the Fall of 2010.

The most current cases applying the revised factors set out in ***Rev. Proc. 2013-34*** is *Howerten v. Commissioner, T.D. Summ. Op 2014015 (2014).* Judge Kerrigan's opinion provides a thorough discuss of the application of each factor and even though the requesting spouse had knowledge of the deficiency, the knowledge is no longer weighted more heavily than the other factors. ***Rev. Proc 2013-14, sec. 3.07, 2013-43 I.R.B. at 398.***