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It's New but Is It Improved: The New Innocent Spouse Provision

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IT'S NEW BUT IS IT IMPROVED?: THE NEW "INNOCENT SPOUSE" PROVISION

I. INTRODUCTION

They hounded her at work. They called her employers, digging for information. They "harassed and bullied" her in front of her children. They threatened to post sheriff notices in her yard and in the newspapers. They threatened to levy her wages. They placed a lien on her home. They seized her only retirement savings. They destroyed her credit rating. But worst of all, they stole her pride. Who is "they" one may ask? The answer would not be a surprise to many Americans: agents of the Internal Revenue Service (I.R.S.).

Josephine Berman was the woman subjected to these events. While married, Josephine Berman signed joint income tax returns with her husband. Her husband claimed deductions for legal expenses incurred during litigation with his partner in an S corporation, which the I.R.S. disallowed, thereby creating a tax deficiency of $62,000. The I.R.S. then located Josephine and assessed her for the deficiency, never attempting to locate her ex-husband. Due to penalties and interest, Josephine now owes approximately $400,000 to the I.R.S. for the tax deficiency.[1]

Filing joint income tax returns creates joint and several liability for which either spouse can be held responsible.[2] Prior to the enactment of the Internal Revenue Restructuring and Reform Act of 1998, the only opportunity for either spouse to escape such liability was to both request "innocent spouse" relief. Unfortunately, "innocent spouse" relief could be obtained only through proving a myriad of difficult standards. Since many truly "innocent spouses," such as Josephine Berman, could not establish one or more of the requirements to obtain relief,[3] they were held liable for mistakes they did not make and problems they did not create. Cries for reform led Congress to consider appropriate revisions to the "innocent spouse" provision. As a result, Congress repealed the former code section granting "innocent spouse relief and enacted a new code section pertaining to "innocent spouse" relief.[4] This article will examine the criticisms of the previous "innocent spouse" provision and proposals for reform that aided Congress in enacting a more equitable provision. The new "innocent spouse" provision, § 6015,[5] will be dissected to reveal the requirements, as well as the changes from the old provision. Also provided in this article will be examples of the new provision applied to cases decided under the old "innocent spouse" provision. Completing this article will be criticisms of the new provision and I.R.S. actions regarding the new provision.

II. BRIEF HISTORY OF "INNOCENT SPOUSE" RELIEF

The joint return was introduced in 1918.[6] However, joint and several liability arising from joint returns was not formally established until 1938 with the implementation of the Revenue Act of 1938, which required that married couples filing jointly be held jointly and severally liable for taxes due on the joint return.[7] In 1971, Congress enacted an "innocent spouse" provision to protect unsuspecting spouses from the imposition of tax liability in situations where one spouse omitted income from the joint return.[8] In 1984, the "innocent spouse" provision was amended to provide relief to an "innocent spouse" for a tax deficiency arising from grossly erroneous deductions, credits, or basis attributable to the other spouse.[9] This

[1] *Innocent Spouse Issues: Restructuring Hearing on the Internal Revenue Service Before the Senate Committee on Finance*, 105th Cong. (1998) (statement of Josephine Berman).

[2] I.R.C. § 6013(d)(3) (1997). Section 6013(d)(3) provides: "[I]f 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."

[3] *See infra* notes 9-10 and accompanying text (explaining these requirements).

[4] I.R.C. § 6013(e), as in effect prior to the Internal Revenue Restructuring and Reform Act of 1998, Pub. L. 105-206, 112 Stat. 685 (1998) (codified as amended in scattered sections of 26 U.S.C.) [hereinafter cited as old § 6013(e)].

[5] I.R.C. § 6015 (1998).

[6] Revenue Act of 1918, Pub. L. No. 65-254, ch. 18 § 223, 40 Stat. 1057, 1074 (1918).

[7] Revenue Act of 1938, Pub. L. No. 75-554, 52 Stat. 447, 476 (1938).

[8] Act of Jan. 12, 1971, Pub. L. No. 91-679, § 1, 84 Stat. 2063 (1971).

[9] Old § 6013(e), *supra* note 4.

provision provided relief from joint and several liability if the spouse seeking such relief was able to prove the following requirements:

A.) a joint tax return was made for the taxable year;

B.) on such joint return there was a substantial understatement of tax attributable to grossly erroneous items of one spouse;

C.) the other spouse was able to establish that he/she did not know nor had any reason to know of such a substantial understatement;

D.) in consideration of all the facts and circumstances, it would be inequitable to hold the other spouse liable for the deficiency attributable to such understatement.[10]

III. PROBLEMS WITH THE FORMER "INNOCENT SPOUSE" PROVISIONS

Though the purpose of the "innocent spouse" provision was noble, the requirements of I.R.C. '6013(e) were too difficult for many "innocent spouses" to overcome. Problems in interpretation and application arose with respect to almost every requirement under I.R.C. § 6013(e). Only the requirement of a joint return was generally unproblematic.[11] Criticisms of the other requirements, though, were numerous.

A. Requirement of a Substantial Understatement of Tax Attributable to Grossly Erroneous Items of One Spouse

A "substantial understatement" of tax was explicitly described as an understatement exceeding $500.[12] The General Accounting Office (GAO) concluded that the dollar threshold excluded some "innocent spouses" from relief and was "inconsistent with the goal of providing relief to deserving taxpayers."[13] Poorer

[10]*Id.*

[11]Old I.R.C. § 6013(e)(1)(A), *supra* note 4. The filing of a joint return was usually one of fact. Basically, only in situations in which a joint return was filed but not signed by both spouses or a spouse claims to not have intended to sign the return was this requirement questioned. In situations where the return was not signed by both spouses, the Tax Court has used a "tacit consent" rule, assuming that the joint return was consented to by the nonsigning spouse if that spouse did not object and did not file a separate return. *See, e.g.,* Ebeling v. Commissioner, 67 T.C.M. (CCH) 3102 (1994). The Tax Court considered the following factors to determine if the nonsigning spouse consented: (1) "whether the nonsigning spouse received any of the benefits of the joint return," (2) "the couple's history of filing joint returns," (3) "whether the nonsigning spouse's income and expenses were reported on the joint return." *Id.* at 3103. In situations where the spouse claims to not have intended to file a joint return, the court reviews the intent, considering the history of filing joint returns. *See, e.g.,* Riportella v. Commissioner, 42 T.C.M. (CCH) 869 (1981). The taxpayer has the burden of proving that he/she did not intend to file a joint return. *Id.*

[12]Old § 6013(e)(3), *supra* note 4.

[13]*GAO Suggest Improvement to IRS's Innocent Spouse Procedures*, 97 TAX NOTES TODAY 49-20 (1997), Doc 97-7078 (44 pages) [hereinafter *GAO Suggests Improvements*]. Pursuant to § 401 of the *Taxpayer Bill of Rights* 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996), the

taxpayers with smaller liabilities were often unable to meet this dollar threshold in order to obtain relief.[14] Critics argued that if the purpose of the section was to provide relief, a dollar limitation should not apply to a truly "innocent spouse."[15]

The understatement was also required to exceed a specified percentage of adjusted gross income based on the most recent year before the deficiency notice was mailed if the understatement related to a deduction, credit, or basis.[16] The GAO cited examples of the application of such specified percentages and found that the thresholds instead related to a taxpayer's ability to pay or degree of hardship rather than the taxpayer's innocence.[17] The basis for determining the specified percentage of adjusted gross income was the preadjustment year, i.e., the most recent year before the deficiency notice was filed, and not the year in which the joint return was filed. The American Bar Association described this preadjustment year test as "irrelevant to the justification for avoidance of the liability" since the taxpayer's liability could have been large but not large enough to overcome the percentage requirements.[18] The GAO estimated that approximately 40,000 additional "innocent spouses" could have been eligible for relief under I.R.C. § 6013(e) if these dollar thresholds had not existed.[19]

General Accounting Office studied and reported on issues regarding joint and several liability, including: (1) the potential universe of taxpayers that may have been eligible for innocent spouse relief, (2) the I.R.S.'s practices and procedures for handling requests for innocent spouse relief, (3) whether the innocent spouse provisions provided the same treatment for all taxpayers, (4) the potential effects of replacing the joint and several liability standard with proportionate liability, (5) the potential effects of requiring the I.R.S. to abide by divorce decrees that allocate tax liabilities, (6) the potential effects on the I.R.S. of changing the law so that community income of one spouse couldn't be seized to satisfy tax liabilities incurred by the other spouse before their marriage. *Id*.

[14] *See, e.g.*, Wolski v. Commissioner, 67 T.C.M. (CCH) 3141 (1994) (Robert Wolski was unable to obtain "innocent spouse" relief because the tax deficiency arising from a joint return filed with his wife was only $256).

[15] Ted S. Biderman, *The Continued Folly of the Innocent Spouse Defense: Is It Viable*, 45 DRAKE L. REV. 551, 553 (1997).

[16] Old § 6013(e)(4), *supra* note 4. This section provided:

> A. if the spouse's adjusted gross income for the preadjustment year is $20,000 or less, this subsection shall apply only if the liability... is greater that 10% of such adjusted gross income.
> B. if the spouse's adjusted gross income for the preadjustment year is more than $20,000, subparagraph (A) shall be applied by substituting 25% for 10%.

Id. The preadjustment year was the most recent taxable year of the spouse ending before the date the deficiency notice was mailed. *Id*.

[17] *GAO Suggests Improvements*, *supra* note 13, at ¶ 31. The GAO dissected the specified percentage requirements, stating that a taxpayer with an AGI of $20,000 or less would be able to obtain relief only on assessments of $2,000 or less while a taxpayer with an AGI of over $20,000 would be able to obtain relief only on assessments of over $5,000. *Id*.

[18] American Bar Association, *Comments on the Liability of Divorced Spouses for Tax Deficiencies on Previously Filed Joint Returns*, 50 TAX LAW. 395, 403 (1997).

[19] *Joint Liability and Its Impact on Innocent Spouses: Hearing on Alternatives for Improving Innocent Spouse Relief Before the House Committee on Ways and Means*, 105th

Under I.R.C. § 6013(e), "grossly erroneous" items constituted an omission from gross income or a deduction, credit, or basis for an amount "in which there is not basis in law or in fact."[20] Courts did not uniformly interpret the clause "basis in law or in fact" since legislative history of the statute failed to provide guidance.[21] The spouse attempting to obtain relief was also given the often impossible task of proving that a deduction had no basis in law or in fact. The spouse attempting to prove the deduction frequently did not have any records or information regarding the deduction.[22] The American Bar Association recognized that this was especially a problem when the spouses were divorced since the spouse claiming "innocent spouse" would have very little chance of obtaining the records necessary to prove that the deduction was either correct or had no basis in law or fact. The ABA thus recommended that the test be abandoned.[23]

B. Knowledge or Reason to Know Requirement

The spouse seeking "innocent spouse" relief must have proven that he/she did not have knowledge nor had any reason to know about the items in question.[24] Courts, though, had varying interpretations of what constituted such knowledge. The Sixth Circuit Court of Appeals held that a person with ordinary intelligence would know if there was a substantial chance of the existence of a discrepancy and would have exercised reasonable care to determine if such a discrepancy existed.[25] The Second, Ninth, and Eleventh Circuit Courts instead considered factors such as the level of the taxpayer's education and involvement in the family's financial affairs or the presence of lavish expenditures to determine if the taxpayer had knowledge of the items.[26] The Tax Court would review to see if constructive knowledge existed by determining if the taxpayer knew or should have known the transaction produced income or if the taxpayer knew the transaction produced a deduction.[27] Without uniformity between the courts, choice of forum often made the difference to those requesting relief.[28]

The knowledge test was also recognized by critics as a "Catch-22," since the taxpayer had to simultaneously prove that her/his spouse's action was illegal and that

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Legis., (1998) (testimony of United States General Accounting Office's Director Lynda D. Willis).

[20]Old § 6013(e)(2), *supra* note 4.

[21]Lisa K. Edison-Smith, *If You Love Me, You'll Sign My Tax Returns: Spousal Joint and Several Liability for Federal Income Taxes and the Innocent Spouse Exception*, 18 HAMLINE L. REV. 102, 107 (1994) (citing H.R. Rep. No. 432, 98th Cong., 2d Sess., pt. 2 at 1502).

[22]*Id.* at 111.

[23]American Bar Association, *supra* note 18, at 403.

[24]Old § 6013(e)(1)(C), *supra* note 4; Edison-Smith, *supra* note 21, at 111.

[25]Shea v. Commissioner, 780 F.2d 561 (6th Cir. 1986).

[26]*See, e.g.,* Hayman v. Commissioner, 992 F.2d 1256 (2d Cir. 1993).

[27]*See, e.g.,* Bokum v. Commissioner, 94 T.C. 126 (1990).

[28]Biderman, *supra* note 15, at 562.

she/he did not know about it.[29] The lack of uniformity in the courts in interpreting the test and the difficulty in proving lack of knowledge hindered many "innocent spouses" from obtaining relief.

C. Requirement that it Would be Inequitable to Hold the Taxpayer Liable

Because the requirements of I.R.C. § 6013(e) were read conjunctively, a taxpayer could still be held liable even if it was found to be inequitable.[30] Possible "innocent spouses" were further denied relief under I.R.C. § 6013(e) because courts tied the inequitable test to a consideration of any "significant benefit" the taxpayer may have gotten from the item in question. If the item in question somehow allowed the taxpayer to enjoy benefits substantially varying from the taxpayer's normal lifestyle, the courts held that the taxpayer should have known about the item.[31] Thus, even if facts and circumstances indicated that it would be inequitable to hold the spouse liable,[32] courts could preclude exoneration from liability by twisting the requirement around to additionally test the knowledge requirement.

IV. CRITICISMS AND PROPOSALS

As critics, scholars, and courts discussed the problems and deficiencies of the "innocent spouse" provision, an increasing number of suggestions and recommendations for changes were published. Some scholars urged the repeal of joint liability,[33] others for the repeal of joint filing.[34] The General Accounting Office, Treasury Department, American Bar Association, and American Institute of Certified Public Accountants all published recommendations on how to fix the mess.[35]

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[29]H.J. Cummins, *Catch 1040: Joint Returns Mean Joint Liability - and in Some Cases, that Means Trouble*, NEWSDAY, Jan. 30, 1994, at 76 (quoting James Lewis, director of free tax clinic at Yeshiva University's Benjamin N. Cardoza Law School).

[30]*See, e.g.,* Jackson v. Commissioner, 72 T.C. 356 (1979) (holding a widow liable for her deceased husband's tax liability because she did not meet all the other requirements of I.R.C. § 6013(e), even though the court found it to be inequitable to hold her liable).

[31]Biderman, *supra* note 15, at 558 (citing Buchine v. Commissioner, 20 F.3d 173 (5th Cir. 1994)).

[32]Old § 6013(e)(1)(D), *supra* note 4.

[33]*See, e.g.,* Richard C.E. Beck, *The Innocent Spouse Problem: Joint and Several Liability for Taxes Should be Repealed*, 43 VAND. L. REV. 317, 329 (1990); Edison-Smith, *supra* note 21; Marjorie Kornhauser, *Love, Money, and the I.R.S.: Family, Income-Sharing, and the Joint Income Tax Return*, 45 HASTINGS L.J. 63 (1993); C. Ian McLachlan, *Spousal Liability and Federal Income Taxes*, 10 J. AM. ACAD. MARTIM. LAW. 65 (1993); Stephan A. Zorn, *Innocent Spouses, Reasonable Women and Divorce: The Gap Between Reality and the Internal Revenue Code*, 3 MICH. J. GENDER & L. 421 (1996).

[34]*See, e.g.,* Amy C. Christian, *The Joint Return Rate Structure: Identifying and Addressing the Gendered Nature of the Tax Law*, 13 J. L. & POL. 241 (1997); Pamela B. Gann, *Abandoning Marital Status as a Factor in Allocating Income Tax Burdens*, 59 TEX. L. REV. 1 (1980); Lawrence Zelenak, *Marriage and the Income Tax*, 67 S. CAL. L. REV. 339 (1994).

[35]*See*, *GAO Suggests Improvements*, *supra* note 13; Treasury Report to Congress on Joint Liability and Innocent Spouse Issues, 98 TAX NOTES TODAY 28-14 (1998), Doc 98-5641 (64 pages) [hereinafter Treasury Report]; ABA Members Recommend Changes in Innocent Spouse Rules, 96 TAX NOTES TODAY 150-30 (1996), Doc 96-21543 (48 pages) [hereinafter

Critics did not only criticize the requirements of I.R.C. Section 6013(e) but also joint and several liability itself. Most spouses are unaware of the joint and several liability arising from filing joint returns. Tax forms did not include any warning of the joint and several liability.[36] The General Accounting Office also noted that I.R.S. publications failed to provide adequate information on how to obtain "innocent spouse" relief, citing this as the reason that the I.R.S. received relatively few "innocent spouse" relief requests.[37] No set procedures or guidance defined how to request "innocent spouse relief."[38]

Critics argue that joint liability is based on an outdated concept of marriage.[39] When joint liability was introduced in 1938, marriages were more stable than today and a couple could be rationally viewed as a single economic unit. However, with around half of all marriages ending in divorce, taxpayers are less likely to stay such a single economic unit and often do not even share assets during marriage.[40] Enforcing joint and several liability seems irrational when the marriage may end sooner than the liability does.[41]

Joint liability also unfairly burdens women. Because women are more likely to stay in the family home after divorce, the I.R.S. predominantly attempts collection from them since they are easier to locate. Richard Beck testified before the House Ways and Means Committee that over 90% of the joint liability collections are against women.[42] This effect results from the I.R.S.'s ability to collect from whichever spouse it chooses. In cases of divorce, the consequence of tax collection from joint liability is extremely harsh on women. Since a woman's standard of living most often decreases after divorce, the effects of I.R.S.'s attempt at collection of tax deficiencies places the woman in an even more unstable financial position.[43]

ABA Members Recommend]; AICPA PROPOSAL COMMENTS ON NOTICE 96-19, STUDY ON JOINT RETURN AND COMMUNITY PROPERTY ISSUES FOR DIVORCED AND SEPARATED TAXPAYERS (July 2, 1996) (proposal was provided directly to the I.R.S.) [hereinafter AICPA PROPOSAL].

[36]Innocent Spouse Issues: Hearing on Taxpayer Rights Before the House Committee of Ways and Means, 105th Legis., (1998) (testimony of Richard Beck). Beck testified to the House Committee that there is no joint and several liability clause on the Form 1040s which would notify the taxpayers of the joint and several liability. He noted that most of those taxpayers held joint and severally liable are surprised. *Id.*

[37]*GAO Suggests Improvements*, *supra* note 13, at ¶ 8.

[38]*Id.*

[39]*See, e.g.*, Edison-Smith, *supra* note 21, at 122-23; Marjorie Kornhauser, *Theory v. Reality: The Partnership Model of Marriage in Family and Income Tax Law*, 69 TEMP. L. REV. 1413 (1996).

[40]*Id.*

[41]*Id.* Also, in most situations the statute of limitations for a tax deficiency is within three years after the return was filed. I.R.C. § 6501(a)(1998). But, if there was an omission from gross income of an amount in excess of the gross income reported on the return, the statute of limitation is instead six years. I.R.C. § 6501(e).

[42]Beck, *supra* note 36.

[43]*Id.* at 329.

Furthermore, studies by scholars suggest that men are more likely to cause a tax deficiency.[44] Men are more likely to be self-employed, which enables them to conceal income easier than people employed by someone else.[45] Psychological studies have also been conducted regarding the reporting manners of men and women, and the results indicate that men are more likely to have more aggressive reporting practices.[46] For example, men are more prone to claim an improper deduction. Also, because men still have higher earnings on average than women, the deficiencies on the return are most likely attributable more often to the husband.

The effects of joint liability violate the fairness and ability-to-pay norms. Joint and several liability allows the collection of taxes from either person, even the "innocent spouse" who did not even earn that income.[47] Since men on average earn higher salaries than women but women are pinpointed for collections of tax deficiencies, the cost of joint liability is usually born by the wrong spouse. Generally, men benefit the most from joint liability as the higher earner, while the wife incurs additional liability for his portion of the taxes.[48] The argument that a significant benefit is available to spouses by filing jointly[49] does not justify joint liability for an amount greater than the actual tax savings that was gained from filing jointly.[50] Critics for the repeal of joint liability point out that the "abolition of joint and several liability would simply assign responsibility for payment where it belongs — with the earner of it."[51]

The United States is the only major country in the world that enforces joint and several liability. Critics argue that this is ludicrous when the United States has the highest divorce rate.[52] The repeal of joint and several liability would eliminate any problems with the "innocent spouse" provision since such a provision would not be needed. No instances of inequitable liability would occur since each person would

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[44]Amy C. Christian, *Joint and Several Liability and the Joint Return: Its Implications* for Women, 66 U. CIN. L. REV. 535, 595 (1998).

[45]*Id*. Christian also points out that if the men are more likely to be self employed, the I.R.S. has a tendency to attempt to collect from the wives because more often the wives would be employed by someone else and the I.R.S. could more easily garnish the wives' wages to pay for the liability. *Id*.

[46]*Id*.

[47]Beck, *supra* note 33, at 325.

[48]*Id*. at 376.

[49]Couples can enjoy a "marriage bonus" by filing a joint return. Due to the progressive nature of the tax rates, couples who file jointly are able to shift income from the higher earner to the lower earner to allow the higher earner's income to be taxed in a lower tax bracket. A tax savings results. This effect is built into tax rate tables themselves. I.R.C. § 1(a) provides the tax rates for married individuals filing joint returns.

Because most married couples still do not have equal incomes, more married couples filing jointly obtain a "marriage bonus." Approximately 95% of married taxpayers file jointly to take advantage of the tax rate schedule. Treasury Report, *supra* note 35, at ¶ 28.

[50]Beck, *supra* note 36.

[51]Zorn, *supra* note 33, at 490.

[52]Beck, *supra* note 33, at 383.

be assessed for the tax deficiency attributable to his/her wages. Critics argued that the abolition of joint liability would not create any substantial problems, pointing to the married-filing-separately returns available now and the formula provided in Revenue Ruling 80-6 to determine separate proportional liability.[53]

Some critics recognized the problems could be resolved not by repealing the joint and several liability provision in I.R.C. § 6013[54] but by abolishing joint returns.[55] Problems arising from the filing of joint returns, such as joint and several liability, would vanish. Critics contend joint returns represents a system that "fits poorly with American attitudes and living patterns."[56] Empirical evidence shows that as many as 50 percent of all couples do not pool their finances nor believe in such a system.[57] Without evidence that couples even view themselves as one economic unit, it seems irrational to allow them the choice to file joint returns which operate under the assumption that the couple is a single economic unit. Changing views of marriage and relationships require the elimination of the joint return. As critic Lawrence Zelenek wrote, "[a] system that is right for one time and place may be wrong for another."[58]

In response to the requirements under the Taxpayer Bill of Rights 2,[59] both the GAO and the Treasury Department published their own analysis of the suggestions to solve the deficiencies regarding joint and several liability. Both the GAO and Treasury evaluated various proposals, determined the problems under each, and determined recommendations based on their findings. The GAO and the Treasury then reported their findings to Congress.

The GAO reviewed three prevalent options: 1) the elimination of joint returns, 2) the modification of joint returns into a column for each spouse, and 3) the application of proportionate liability when there was a delinquent or subsequent tax assessment.[60] The elimination of joint returns would be beneficial in clearly establishing each spouse's individual liability, at the cost of preparing two separate returns and receiving no true benefit while married under the current tax rate structure.[61] Required filing of separate returns would also substantially increase costs to the I.R.S. due to processing and matching informational returns to income reported for approximately 48 million more tax returns a year.[62] The true effect of

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[53]*Id*. at 394 (citing Revenue Ruling 80-6, 1980-1 C.B. 296).

[54]I.R.C. § 6013(d)(3).

[55]Zelenak, *supra* note 34, at 405.

[56]*Id*.

[57]Kornhauser, *supra* note 33, at 86 (determining such a percentage by reviewing the conclusions of three studies regarding issues of marriage and money). *Id*. at 85-91.

[58]Zelenak, *supra* note 34, at 404-05.

[59]*Taxpayer Bill of Rights* 2, *supra* note 13.

[60]*GAO Suggest Improvements*, *supra* note 13, at ¶ 39.

[61]*Id*. at ¶ 39, table 1.

[62]*Id*. at ¶ 44.

such a proposal is best reflected in monetary terms: The I.R.S. would have to spend approximately $199 million a year to process the additional tax returns.[63]

The proposals to modify joint returns to reflect a column for each spouse in order to determine the proportional liability of each spouse posed many of the same problems raised by the elimination of joint returns. While the individual liability of each spouse would be established by use of the forms, the benefit would not outweigh the costs to the I.R.S. The estimated cost for the additional data entry that would be required under this proposal was $19 million.[64] The GAO identified a significant burden to taxpayers implicated under both the proposal for separate returns and the proposal for modified returns. Of the 48 million couples that file jointly, only 9% had unpaid tax liabilities or subsequent tax assessments.[65] To change the current filing system for only 9% of joint filers would defy logic. Also, under both separate and modified filing proposals, it would be difficult for the I.R.S. to determine if jointly held income was correctly apportioned.[66]

Though the GAO assessed that proportionate liability would be the least costly option, it recognized that such proportionate liability would also have administrative burdens on the I.R.S.[67] The GAO did not, however, recommend this proposal or the proposal for separate or modified filing. The GAO instead recommended that the I.R.S. (1) develop new or modify existing publications to better inform and educate taxpayers about the availability and requirements for "innocent spouse" relief and (2) develop tax forms and procedures to request "innocent spouse" relief.[68]

Similar to the GAO, the Treasury Department evaluated various proposals for their respective strengths and weaknesses and determined if each proposal would substantially increase or decrease the burden on taxpayers and the government and if the proposal would attain the goal of lessening the current difficulties with joint and several liability.[69] The Treasury reviewed proposals for: 1.) mandatory separate returns, 2.) proportionate liability, 3.) allocated liability, 4.) liability in accordance with divorce decrees, and 5.) improvements to the innocent spouse provisions.[70]

The Treasury noted many of the same problems as the GAO in the proposal for mandatory separate filing, noting that benefits would not overcome the burdens and complexities that would arise. Mandatory separate returns would increase the administrative burden on the I.R.S., violating the basic premise on which joint returns were first introduced.[71] Furthermore, because a formula would be used to

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[63] *Id.*

[64] *Id.* at ¶¶ 39, 42.

[65] *GAO Suggest Improvements*, *supra* note 13, at ¶ 40.

[66] *Id.* at ¶ 44.

[67] *Id.* at ¶¶ 47, 63.

[68] *Id.* at ¶ 64.

[69] Treasury Report, *supra* note 35, at ¶ 81.

[70] *Id.*

[71] *Id.* at ¶ 88. The Treasury noted that the legislative history on joint returns indicates that the main purpose was for administrative ease on the I.R.S. *See* H.R. 1860, 75th Cong., 2d sess., 1939-1 C.B. 749 (1939).

allocate tax items, the Treasury concluded that this would inevitably result in allocation not reflective of the spouse's actual contributions, undercutting the rationale of requiring separate filing.[72]

The Treasury reviewed front-end proportionate liability proposals which would require married taxpayers to file jointly but separately report tax items on the return. Again, the Treasury, like the GAO, noted administrative burdens on the I.R.S., such as the costs to change the computer systems and to enter the additional data.[73] "innocent spouse" provisions would still be required to provide relief in situations where the allocation on the tax return between the spouses was incorrect.[74]

The back-end proportional liability proposal by the American Bar Association would allow married couples to file a joint return and would require allocation of items only upon either spouse's election after the assessment of unpaid taxes or assertion of a tax deficiency.[75] The Treasury found that taxpayers would be required to maintain extensive and sufficient records in case of unpaid taxes or a tax deficiency but that the proposal would not adversely affect the I.R.S.' return-processing procedures.[76] Though this proposal would preserve the benefits of filing jointly, some "innocent spouse" relief would still be required to protect an "innocent spouse" in situations where the spouse overpaid his/her relative tax liability but not the joint liability.[77]

The Treasury critiqued the American Institute of Certified Public Accountant's proposal for an allocated liability standard.[78] The allocated-liability proposal would allow the filing of a joint return but once the joint tax liability was determined, the spouses would provide an allocation to each spouse of that total joint tax liability on their return. A default rule would provide 50/50 allocation.[79] However, spouses would run into difficulty in determining the allocation and the possibility of collusive abuse between spouses would arise. For example, the spouses could allocate most of the liability to the spouse without any assets.[80] The Treasury also concluded that an "innocent spouse" provision would still be required for relief on disputes regarding the allocation.[81]

The Treasury also found problems in the proposal to allocate liability pursuant to divorce decrees. Due to the nature of divorce proceedings, a fair allocation would be unlikely and the Treasury was not clear on how the government's interest in collecting the proper amount of revenue could be protected.[82]

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[72]Treasury Report, *supra* note 35, at ¶ 91.

[73]*Id*. at ¶ 114-17.

[74]*Id*. at ¶ 125.

[75]*Id*. at ¶ 126 (referring to ABA Members Recommend Changes, *supra* note 35).

[76]Treasury Report, *supra* note 35, at ¶ 133-35.

[77]*Id*. at ¶ 140.

[78]AICPA PROPOSAL, *supra* note 35.

[79]Treasury Report, *supra* note 35, at ¶ 146.

[80]*Id*. at ¶ 153.

[81]*Id*. at ¶ 156.

[82]*Id*. at ¶ 160-63.

After review of the different proposals, the Treasury concluded that the most appropriate method to decrease the problems arising from joint and several liability was to reform the "innocent spouse" provision to accommodate more cases. The Treasury specifically suggested that the requirement of a "substantial understatement" be amended to include any underpayment of tax and not include any dollar thresholds.[83] With respect to the "grossly erroneous" requirement, the Treasury recommended the elimination of "no-basis-in-law-or-in- fact" test to equalize treatment of similarly situation taxpayers. Further, it recommended elimination of the requirement that an understatement be attributable to a grossly erroneous item to extend relief to situations where an understatement was not attributable to an omission of income or an erroneous claim of a deduction or credit.[84] The Treasury recommended a list of factors to be considered by the courts and the I.R.S. for both the "knowledge" and the "inequitable" requirements, while also recommending an expansion of Tax Court jurisdiction.[85]

Concluding that sound policy reasons existed for the continuance of joint filing and joint and several liability, the Treasury failed to endorse any of the proposals that would have abruptly changed the method of filing or allocating liability.[86] The Treasury instead recommended the promulgation of legislation to: 1.) automatically suspend collection efforts against one spouse when the other is contesting a proposed joint assessment in Tax Court, 2.) provide "innocent spouse" relief to more individuals by changing statutory standards to include those with smaller tax bills, and 3.) allow more taxpayers who are denied "innocent spouse" relief an opportunity to appeal the I.R.S.'s decision to the Tax Court and automatically suspend collection attempts until the Tax Court's decision.[87]

V. CONGRESSIONAL ACTION

With the release of the GAO's and Treasury's findings on joint liability and the "innocent spouse" provision, Congress took action in the beginning of 1998. Scholars, tax professionals, and "innocent spouses" flocked to Washington, D.C., with the hopes of influencing the final outcome of any new litigation.[88] Both the

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[83] *Id*. at ¶ 210.

[84] Treasury Report, *supra* note 35, at ¶ 211-12.

[85] *Id*. at ¶ 216-20.

[86] *Id*. at ¶ 225-26. The Treasury relied on four factors in concluding that joint returns were based on sound policy: (1) joint returns treated marriages as one economic unit, (2) joint returns permitted spouses to offset each other's income and losses, (3) joint returns provided those couples in similar situations to pay the same tax, and (4) joint returns permitted couples in common law property states to have the same income-splitting available to those in community property states. *Id*. The Treasury also noted that joint and several liability was appropriate in most cases. *Id*.

[87] *Id*. at ¶ 229.

[88] Examples of people testifying before the House Ways and Means Subcommittee:

1. Donald Lubick, Treasury Assistant Secretary, *see* Joint Liability and Its Impact on Innocent Spouses, 105th Legis., (1998) (testimony of Donald Lubick).

House Ways and Means Committee and the Senate Finance Committee entertained testimonies and statements by such individuals to aid in the determination of the appropriate new legislation.[89] However, the bills that came out of the House and Senate varied greatly.

The House of Representatives created a House Bill to embody their version of reform. The House was obviously comfortable with the Treasury's suggestions, including many in the House Bill.[90] Following the Treasury, the House Bill contained the elimination of the "grossly erroneous" requirement, replacing it with a requirement that an item simply be "erroneous."[91] House Bill also called for the removal of dollar and percentage thresholds for a "substantial understatement"and expansion of Tax Court' jurisdiction, both of which are reflected in the Treasury' suggestions.[92] Unlike the Treasury, the House also incorporated "portioned relief"in the House Bill. Under "portioned relief,"a spouse could be relieved of liability to the extent that the liability is attributable to a portion of the understatement that the spouse did not know of nor had any reason to know.[93]

The Senate was more liberal, endorsing a proportionate liability approach similar to the ABA's proposal. Under the Senate Amendment, a spouse could elect to limit joint liability and thus would only be liable to the extent that items giving rise to the deficiency were allocable to that spouse.[94] Allocations would follow present law rules of determining which spouse has the responsibility for reporting under the married- filing-separate status. Income items would follow the source while income from joint investments/ businesses would be allocated equally. Deductions would follow ownership of the businesses but personal deductions would be divided equally.[95] The election to limit liability would apply also to taxes shown on the return but not paid.[96] The Senate Amendment also included the proposal for

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2. Richard Beck, Professor *see* Innocent Spouse Issues: Hearing on Taxpayer Rights Before the House Committee of Ways and Means, 105th Legis., (1998) (testimony of Richard Beck).

Examples of people testifying before the Senate Finance Committee:

1. Josephine Berman, "innocent spouse," *supra* note 1.

2. Karen Andreasen, "innocent spouse," *see Innocent Spouse Issues: Restructuring Hearing on the Internal Revenue Service Before the Senate Committee on Finance*, 105th Cong. (1998) (statement of Karen J. Andreasen).

3. David Keating, Senior Counsel, National Taxpayers' Union, *see Reform of the Innocent Spouse Issues Before the Senate Committee on Finance*, 105th Cong. (1998) (testimony of David Keating).

[89] *Id.*

[90] H.R. REP. 364(I), 105th Cong. (1998).

[91] *Id.*; Treasury Report, *supra* note 35.

[92] H.R. REP. 364(I), 105th Cong. (1998).

[93] *Id.*

[94] S.174, 105th Cong. (1998).

[95] *Id.*

[96] *Id.*

additional rules to aid the I.R.S. in preventing inappropriate use of the election, such as denying separate liability when fraud existed or the spouse had actual knowledge (proven by evidence) of the "erroneous" item.[97] Under the Senate Amendment, the I.R.S. would be required to notify all joint filers of their right to elect this separate liability.[98]

VI. THE RESULT

Faced with two differing Congressional bills, the Conference Committee created the new "innocent spouse" provision, I.R.C. § 6015, which included various sections of both the House Bill and the Senate Amendment.[99] The new provision was signed by President Clinton on July 22, 1998, becoming law and repealing the prior "innocent spouse" provision, I.R.C. § 6013(e). The new provision provides relief upon the fulfillment of the following requirements:

A) a joint return was filed;

B) the understatement of tax was attributable to an erroneous items of one individual filing the return;

C) the taxpayer requesting relief establishes that he/she did not know, and had no reason to know, of such an understatement;

D) it would be inequitable to hold the taxpayer liable.[100]

With a quick glance, differences between the previous "innocent spouse" provision I.R.C. § 6013(e) and the new provision I.R.C. § 6015 seem minimal.[101] However, a more detailed review of I.R.C. § 6015's main requirements for "innocent spouse" relief reveals that certain words have been subtly deleted, creating quite a difference between the old and the new. The "understatement" under I.R.C. § 6015 is not required to be "substantial," such as the $500 or percentage threshold required under old I.R.C. § 6013(e).[102] Also unlike old I.R.C. § 6013(e), the taxpayer requesting relief does not have to prove that the "erroneous" items were "grossly erroneous" or have "no basis in law or fact," requirements that had led to differing interpretations among the courts.

The new provision I.R.C. § 6015 includes more fundamental changes. Though the knowledge" test still exists in I.R.C. § 6015, a taxpayer may be liable only for the

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[97]*Id.*

[98]*Id.*

[99]I.R.C. § 6015 (1998).

[100]*Id.*

[101]*See supra* note 9, and accompanying text (listing the requirements of old I.R.C. § 6013(3)).

[102]The "understatement" required under I.R.C. § 6015(b)(1)(B) is defined by § 6662(d)(2)(A), which defines "understatement" as "the excess of the amount of the tax required to be shown on the return for the taxable year, over the amount of the tax imposed which is shown on the return, reduced by any rebate."

portion of the understatement of which the taxpayer knew or had reason to know existed.[103] The new provision also expands the Tax Court's ability to determine appropriate relief and disallows any I.R.S. collection on an assessment until the Tax Court's decision is final or during the ninety-day period that the taxpayer has to petition the Tax Court.[104] This change allows the taxpayer to petition the Tax Court without having to pay the assessment first. Upon attempting to assess a tax deficiency, the I.R.S. is now required to send a notice to both filers of the joint return under I.R.C. § 6015 instead of freely choosing which spouse to notify.[105]

Section 6015 also makes it easier for a taxpayer to obtain equitable relief than under old I.R.C. § 6013. If the taxpayer can not prove the four main requirements to obtain "innocent spouse" relief, equitable relief may still be available under regulations for equitable relief to be issued under I.R.C. § 6015.[106] Such regulations can provide relief for underpayments of tax that are not covered under the statutory language of I.R.C. § 6015, which includes only "understatements." The I.R.S. released interim guidance regarding the requirements for equitable innocent spouse relief on December 7, 1998, under Notice 98-61.[107]

To obtain equitable relief under I.R.C. § 6015(f), the taxpayer must have made a joint return for the taxable year for which relief is sought, the taxpayer could not obtain relief under I.R.C. § 6015(b) or I.R.C. § 6015(c), relief was applied for within two years of the first collection attempt, liability is still owed at the time the relief is requested, no assets were transferred between the spouses as part of a fraudulent scheme, no disqualified assets were transferred, and the individual did not file the joint return with fraudulent intent.[108] Notice 98-61 also set out circumstances under which equitable relief from tax liability would ordinarily be granted: 1.) The liability reported on the joint return was unpaid at time filed; 2.) the individual is no longer married to or is separated from the other individual on the joint return; 3.) the individual did not know nor had any reason to know the tax would not be paid and it was reasonable to believe the spouse would pay the liability; and 4.) the individual would suffer undue hardship if relief was not granted.[109] The I.R.S. also established factors weighing in favor of equitable relief and factors weighing against granting equitable relief for those taxpayers who requested equitable relief but did not meet any of the circumstances in which equitable relief would ordinarily be granted. These factors include the marital status of the requesting taxpayer, any hardships the taxpayer would endure if held liable, the existence of abuse, and a legal obligation by the non-requesting spouse pursuant to a divorce decree.[110] Creation of the deficiency by the requesting spouse, knowledge or reason to know of the deficiency by the

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[103]I.R.C. § 6015(b)(2).

[104]I.R.C. § 6015(e).

[105]I.R.C. § 6015(d).

[106]I.R.C. § 6015(f).

[107]I.R.S. Notice 98-61, 1998-51 C.B. 13.

[108]*Id*. at 14. *See infra* note 154 (providing the definition of a "disqualified asset").

[109]*Id*.

[110]*Id*.

requesting spouse, significant benefits to the requesting spouse, and the requesting spouse's legal obligation were factors the I.R.S. determined to weigh against equitable relief.[111]

Proportional liability represents the most radical change between the old and new "innocent spouse" provision. Section 6015 allows a taxpayer, who is either divorced or separated from the spouse with whom the taxpayer filed a joint return, to elect to limit his/her joint liability relating to that return.[112] If the election is made, the taxpayer will be only liable for the portion of a deficiency allocable to that taxpayer.[113] The taxpayer, however, must elect separate liability within two years after the date the I.R.S. has begun collection activities.[114] I.R.C. § 6015 establishes rules to ensure against improper abuse of the election. For example, election is disallowed if the taxpayer had actual knowledge of the item creating the deficiency or if a fraudulent transfer of assets occurred.[115]

VII. EXAMPLES OF THE APPLICATION OF I.R.C. § 6015

Examples will be provided to best understand the requirements of I.R.C. § 6015. The first two examples will use the facts and circumstances of Josephine Berman's case.[116] The facts will be varied appropriately to apply to the different situations that I.R.C. § 6015 addresses. The following examples will be based on actual cases and will unveil the differences in application between the old I.R.C. § 6013(e) and the new provision, I.R.C. § 6015.

Main Facts for Examples 1 and 2: While married, Josephine Berman filed joint returns with her husband, Bob.[117] The I.R.S disallowed deductions in relation to Bob's subchapter S corporation in the years 1968-1970, creating a deficiency of $62,000. Josephine was never involved in her husband's business activities nor was involved in any business or tax decisions. Josephine's only function regarding tax issues was to sign the joint return. Josephine had three children and made $13,000 per year as a dental assistant. Josephine would never be able to pay off the $62,000 liability herself and would never be able to retire.[118]

A. *Example 1*

Assume that Josephine is still married to Bob. The I.R.S. is attempting collection activities for the deficiencies. Josephine applies for "innocent spouse" relief under

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[111] *Id*. at 14-15.

[112] I.R.C. § 6015(a) provides the election while I.R.C. § 6015(c) describes the method and regulations relating to electing separate liability.

[113] I.R.C. § 6015(c)(1).

[114] I.R.C. § 6015(c)(3)(A).

[115] I.R.C. § 6015(c)(3)(C).

[116] *See supra* note 1 and accompanying text (describing Berman's statement).

[117] Though in her testimony Berman did not state her former husband's name, let's call him Bob in these examples.

[118] Berman, *supra* note 1.

I.R.C. § 6015 within two years of date the I.R.S. began collection activities. No fraudulent transfers of property took place between Josephine and Bob.

In assessing if Josephine is eligible for "innocent spouse" relief under new § 6015, the I.R.S. first considers the requirements of I.R.C. § 6015(b).[119] It can be easily established that Josephine and Bob did file joint returns for the 1968-1970 taxable years. The erroneous deduction of legal expenses by Bob constitutes an "understatement" of tax. The lack of knowledge requirement may be harder to prove. The facts of the case seem to arguably indicate that Josephine did not know of the deduction. Josephine only signed the tax returns and was not part of any business or tax decision. Even if the I.R.S. does disagree with this conclusion, Josephine can elect separate liability under I.R.C. § 6015(b)(2). Under this section Josephine can be relieved of the portion of the liability of which she did not know. A review of the facts may lead to the conclusion that she should not be liable for any portion of the deficiency because she did not know about any part of it, though there is uncertainty regarding how the I.R.S. or courts will determine if a spouse knew of the item or had any reason to know of it.

Under the facts and circumstances, it would arguably be inequitable to hold Josephine liable for the deficiency, as required under the final requirement of I.R.C. § 6015. With three children to care for and a salary of $13,000, Josephine would be financially strapped if held liable.

Josephine could possibly obtain equitable relief under I.R.C. § 6015(f) even if the I.R.S. denied her request for relief under I.R.C. § 6015(b) for failing to meet one of the requirements discussed in the above paragraphs. To obtain equitable relief under I.R.C. § 6015(f), Josephine must meet the requirements prepared by the I.R.S. in Notice 98-61.[120] The threshold requirements under Notice 98-61 are easily met by Josephine. Josephine did file a joint return for the taxable year in which relief is requested, applied for relief within the requisite time period, did not have any assets transferred to her husband, and did not file with fraudulent intent. The I.R.S. would next consider the factors weighing against and for holding Josephine liable. Josephine can argue that she would suffer an undue hardship if she were held liable, citing her low salary, the needed support of her children, her education level, and the enormous amount of the liability. Since none of the liability was attributable to her, there was no evidence she knew of the deficiency when the taxes were filed, and she received no significant benefit for the deficiency since it related to Bob's business, there seems to be no factors weighing against granting her equitable relief. Even if Josephine was not granted "innocent spouse" relief under I.R.C. § 6015(b), she still has a chance to receive equitable relief under I.R.C. § 6015(f). However, if the I.R.S. decided otherwise, under I.R.C. § 6015(e), Josephine can petition the Tax Court for review and defer the I.R.S.'s collection activities until the Tax Court's decision.

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[119] *See supra* notes 99-100 and accompanying text (describing the requirements of I.R.C. § 6015).

[120] *See supra* note 107-11 and accompanying text (describing the requirements of Notice 98-61).

B. Example 2

Assume that Josephine and Bob divorced three years before the I.R.S. began collection activities for the $62,000 deficiency. Josephine filed for relief under I.R.C. § 6015 within the requisite time period. No fraudulent transfers of property between Bob and Josephine took place.

Under I.R.C. § 6015, divorced or separated spouses have an easier path to limit their liability. Josephine could apply for separate liability under I.R.C. § 6015(c) since she is divorced and did not live in the same household as Bob for the year prior to the date she filed the election, no fraudulent transfers or transfers of disqualified assets occurred, and she applied for the election within the requisite time period. Meeting those requirements provides Josephine exemption from all deficiencies for which she is not responsible. Since allocation of the tax items are allocated as if Josephine and Bob had filed married- filing-separate returns, Josephine would not be held liable for any of the deficiency. Because the deficiencies related to Bob's S corporation, the "erroneous" deductions would have been included on Bob's separate return. Thus, Josephine is exonerated from liability for the items allocable to Bob.

C. Example 3

Vicki Michaels applied for "innocent spouse" relief under I.R.C. § 6013(e) in 1995 when the I.R.S. determined that Vicki and her husband had a tax deficiency of $99,584 due to disallowed short term and ordinary losses and disallowed commodity trading deductions from their 1976 joint income tax return.[121] The specific issues were whether the substantial understatement was attributable to grossly erroneous items and whether it would be inequitable to hold Vicki liable for the deficiency.[122] Though Vicki contended that the transactions giving rise to the deficiencies were shams and thus the losses reported were grossly erroneous, the I.R.S. disagreed. The Tax Court concluded that because Vicki could not prove that there was no basis in law for the loss deductions, the items were not "grossly erroneous."[123]

On the issue of inequity, the Tax Court held that it was not "inequitable" to hold Vicki liable because she had received joint and several benefits from the loss when it was claimed. Evidence of jewelry worth $6,000 given to Vicki from her husband and a trip to Europe was used as the basis for the Tax Court's conclusion that Vicki received a significant benefit from the tax deficiency.[124]

It is unfortunate for Vicki that her case occurred in 1995 under old § 6013(e) instead of the new provision, I.R.C. § 6015. If Vicki would have requested relief under I.R.C. § 6015, she would not have had to prove that the deductions were "grossly erroneous" or that they had no basis in law or in fact. Proof that the deduction was just "erroneous" will suffice under I.R.C. § 6015.

The "inequitable" test under I.R.C. § 6013(e) still survives under I.R.C. § 6015(b). Thus, there is uncertainty whether the courts and the I.R.S. will still consider the receipt of "significant benefits" as a test in determining inequity.

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[121] Michaels v. Commissioner, 69 T.C.M. (CCH) 3056, 3057 (1995).

[122] *Id*. at *3.

[123] *Id*. at *4.

[124] *Id.* at *5.

However, I.R.C. § 6015 would have provided Vicki with another method of requesting relief due to inequity under I.R.C. § 6015(f). After considering the hardship that would be imposed on Vicki[125] if she were held liable as a factor indicating inequity under Notice 98-61, the Tax Court might have decided differently. Poor Vicki. If her case had been heard pursuant to I.R.C. § 6015, she might not have been jointly liable for the $99,954 deficiency.

D. Example 4

Robert Wolski was denied "innocent spouse" relief by the Tax Court because he failed to meet the "substantial understatement" requirement of the prior "innocent spouse" provision, I.R.C. § 6013(e).[126] Robert's former spouse, Janet, had received self-employment income of $1,996.50 and failed to report it on their 1989 joint return, resulting in a tax deficiency of $256.[127] Robert was denied "innocent" spouse relief under the Tax Court's holding that the item was not "grossly erroneous" under I.R.C. § 6013(e) because the item did not affect a deduction, credit, or basis and because the tax deficiency was not "substantial."[128] I shall consider for this example only the "substantial understatement" requirement and not the "grossly erroneous" requirement since it was discussed in Example 3. Because the tax deficiency was only $256, it did not constitute a substantial understatement under old I.R.C. § 6013(e), which required an item of at least $500. Under I.R.C. § 6015, however, dollar thresholds are nonexistent and thus even a small tax deficiency of $256 would constitute an "understatement." Robert would have also been able to prove under I.R.C. § 6015 that the "understatement" was attributable to the other filing spouse, Janet. The tax deficiency was easily traceable to Janet, who had earned the self-employment income.

E. Example 5

Andrew Justi was denied "innocent spouse" relief under I.R.C. § 6103(e) by the Tax Court because he failed the "knowledge" requirement.[129] Andrew's wife had been employed as a secretary with an annual salary of $16,185. After a promotion to director of the employee activities department, Andrew's wife received consulting fees from her company and commissions from vendors. Andrew and his wife subsequently bought a new home, increasing their monthly mortgage payments substantially. Andrew, though, gave his paychecks to his wife who paid all the bills and managed the household finances.[130] The Tax Court held that Andrew should have realized that income was omitted from the joint returns with his wife and that he should have investigated further into the possible omission.[131] The Tax Court, after reviewing Andrew's standard of living and his level of education, concluded

[125] *Id.*

[126] Wolski v. Commissioner, 67 T.C.M. (CCH) 3141 (1994).

[127] *Id.* at *1.

[128] *Id.* at *2.

[129] Justi v. Commissioner, 68 T.C.M. (CCH) 717 (1994).

[130] *Id.* at *2.

[131] *Id.* at *4.

that the Justi's standard of living increased due to Mrs. Justi's omission of income and that Andrew was a well-educated engineer and thus should have known about the omission.[132]

Though Andrew's request was denied because he should have known of the omission, the facts of the case indicated that he only actually knew of $700 that his wife omitted from income on their return, as opposed to the $45,000 for which he was held jointly liable. Though a court could possibly find that Andrew should have known about the omission under I.R.C. § 6015 also, it is worth discussing the manner in which Andrew could have escaped liability under I.R.C. § 6015. Andrew could have been held liable only for the $700 omission[133] that he actually knew about under "apportionment of relief," I.R.C. § 6015(b)(2). Under this section, Andrew would be liable only for the portion of the understatement of which he was aware, $700, and he would not be liable for the portion of the understatement of which he was not aware, approximately $44,300. The difference between old § 6013(e) and the new provision I.R.C. § 6015 would have made quite a difference in Andrew's liability.

F. Example 6

Elizabeth Stiteler was held jointly and severally liable for approximately $470,000 because the Tax Court concluded that she failed to prove that it would be "inequitable" to hold her liable, as required under I.R.C. § 6013(e).[134] Elizabeth did not work the majority of her marriage and was only making $6 an hour when she was assessed for tax deficiencies arising from joint returns she had filed with her ex-husband. When Elizabeth and her husband divorced, Elizabeth received proceeds from the sale of a home, secured notes, spousal maintenance, cash, and a condominium.[135] The Tax Court concluded that Elizabeth failed the "inequitable" element because she received an "indirect benefit" due to the transfer of property pursuant to her and her husband's divorce. The property in question had been purchased by her husband with the money available from understating their taxes, the court concluded.[136]

If Elizabeth's request for "innocent spouse" relief would have been under I.R.C. § 6015, the outcome may have been different. Since the requesting spouse may still receive equitable relief under I.R.C. § 6015(f) even if the requirements of I.R.C. § 6015(b) are not all met, Elizabeth may have received equitable relief under this new provision. Elizabeth pointed out to the court that she would suffer a severe hardship if she were held jointly liable for the huge tax deficiency because she earned only $150 every two weeks.[137] Notice 98-61 names "hardship" as one of the factors to consider in determining if equitable relief should be provided. The evidence of such a meager income in the face of a huge liability may have swayed

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[132] *Id.*

[133] *Id.*

[134] Stiteler v. Commissioner, 69 T.C.M. (CCH) 2975 (1995).

[135] *Id.* at *3.

[136] *Id.* at *5.

[137] *Id.* at *6.

the Tax Court to allow equitable relief to Elizabeth. Another factor considered under Notice 98-61 is the non-requesting spouse's legal obligation pursuant to a divorce decree or agreement for any liabilities.[138] Elizabeth and her husband signed a separation agreement which stated that the husband would be liable for all liabilities for federal or state income taxes, penalties, or interest.[139] Between the satisfaction of the hardship and legal obligation factors, Elizabeth would likely have received relief under I.R.C. § 6015.

G. Example 7

The Tax Court denied John DeMott "innocent spouse" relief under I.R.C. § 6013(e) because John had reason to know of a "substantial understatement."[140] John's wife was in an alcoholic rehabilitation program when John was calculating their taxes. John's wife, who managed a newsletter business, simply told John to estimate her wages as about half as much as the previous year. No evidence indicated he knew the actual amount of her wages.[141] Though he was denied relief under I.R.C. § 6013(e) in 1994, John may have fared better if he had been applying under I.R.C. § 6015.

John was divorced from his wife in 1990.[142] If John had been requesting relief under I.R.C. § 6015, he could have elected proportional liability under I.R.C. § 6015(c). No evidence in John's case existed to demonstrate that: 1) John had actual knowledge of the deficiency, 2) John and his wife fraudulently transferred assets, or 3) John and his ex- wife were still living in the same household at the time of the proportionate election.[143] Thus, it appears that John would have satisfied the required elements of I.R.C. § 6015(c) to obtain proportionate liability.[144] John would have likely been liable only for the deficiency attributable to his tax items.

VIII. CRITICISMS AND COMMENTS ON THE NEW PROVISION

As the examples above demonstrate, the differences between the previous "innocent spouse" provision, old § 6013(e), and the new I.R.C. § 6015 can seem substantial. However, the examples above may also provide insight to some of the problems that may still be evident under I.R.C. § 6015. Critics have already zoned in on such possible problems.

The new provision fails to provide relief in situations where the correct tax was shown on the tax return, but the tax was not paid.[145] The main requirements for

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[138]*See supra* notes 107-11 and accompanying text (describing the factors considered under Notice 98-61).

[139]*Stitler*, *supra* note 134.

[140]DeMott v. Commissioner, 68 T.C.M. (CCH) 56 (1994).

[141]*Id*. at *1 at 57.

[142]*Id.*

[143]*Id.*

[144]*See* I.R.C. § 6015(c)(3)(C); I.R.C. § 6015(c)(3)(A)(ii); I.R.C. § 6015(c)(3)(A)(i)(II).

[145]Toni Robinson & Mary Ferrari, *The New Innocent Spouse Provision: Reason and Law Walking Hand in Hand?,* 98 TAX NOTES TODAY 158-60, 846 (1998), Doc 98-25818 (15 pages).

"innocent spouse" relief found in I.R.C. § 6015(c) provides for relief only from an "understatement of tax attributable to erroneous items."[146] Though Notice 98-61 provides equitable relief for such unpaid tax, the taxpayer is required to once again proceed through a myriad of requirements to obtain such a relief.[147] Relief for such unpaid taxes may prove hard to obtain.

Critics point out that a no-fault system was created for divorced or separated spouses while a taxpayer who is still married still must overcome the inherent stigma of guilt and innocence built into the provision.[148] For example, divorced spouses may simply file for proportional liability under I.R.C. § 6015(c) while a married taxpayer must prove each of the elements of I.R.C. § 6015(c) in order to obtain relief. The married taxpayer is forced to disprove that he/she had knowledge of the item creating the deficiency, forcing the taxpayer to disprove his/her "guilt" in overlooking such an item. The divorced taxpayer is allowed to skip this step and can be immediately cleared of all liability if none of the deficiency is allocable to him/her. The married taxpayer is theoretically punished for staying married. Such a concept is contrary to the underlying principle of joint returns: viewing a couple as one lasting economic unit.

Divorced taxpayers requesting relief also have one more method of obtaining such relief, as compared to the married taxpayers. Divorced or separated taxpayers can chose proportional liability under I.R.C. § 6015(c) or "innocent spouse" relief under I.R.C. § 6015(b). However, a married taxpayer has only one shot at obtaining relief, through "innocent spouse" relief under I.R.C. § 6015(b). Again, this punishes marriage and critics wonder if it even encourages marital breakups.[149] Divorced taxpayers who would have been liable under I.R.C. § 6013(e) now are able to simply elect proportionate liability while married taxpayers are not so lucky to have such a provision apply.[150]

Critics also claim that the new provision provides opportunities for taxpayers to manipulate the system.[151] For example, sham divorces could occur just to take advantage of the proportionate liability. Critics claim, "[n]othing in the new provision appears to prevent taxpayers from engaging in a sham divorce; that is, nothing appears to prevent former joint filers from obtaining a divorce to obtain the benefits of proportional liability while continuing to cohabit."[152] It is unlikely, though, that this abuse would occur in great quantities since most couples would not sacrifice marriage for a tax break.

Critics state that transfers to third parties while one spouse claims proportionate liability could occur. Critics question if situations could arise where spouses separate for twelve months, then have the low earner spouse elect proportional

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[146]I.R.C. § 6015(b)(1)(B).

[147]*See supra* note 107 and accompanying text (describing the requirements of Notice 98-61).

[148]Robinson, *supra* note 145, at 846.

[149]*Id.* at 847.

[150]*Id.*

[151]*Id.* at 848.

[152]*Id.* at 847 n.94.

liability while the other spouse transfers assets to a third party.[153] Internal Revenue Code § 6015, however, contains various subsections to prevent spouses who attempt fraudulent schemes from successfully obtaining relief.[154]

Section 6015 also fails to provide all the necessary rules to apply proportionate liability, nor does it require a complete recalculation of tax liability.[155] Unless a Treasury Regulation can aid in such determinations, differing interpretations among courts could occur. Each court may determine a different formula. Like under the old I.R.C. § 6013(e), the variations among forums could lead to completely different results in similar situations.

The most controversial element of the new provision, proportionate liability, is also creating a stir among critics. All taxpayers going through a divorce will now rush to make the proportional election.[156] As written in the *Matrimonial Strategist*, "[p]art of every divorce lawyer's repertoire will be the filing of a separate tax return election with the Internal Revenue Service."[157] Divorce lawyers will use the proportionate liability election as a "bargaining tool" in divorce proceedings.[158]

However, Christopher Rizek, associate tax legislative counsel at the Treasury, warned that such premature filings could "constitute malpractice for protecting them from something that doesn't exist."[159] Furthermore, Rizek pointed out that the I.R.S. would be overcome with paperwork and records if, in every divorce proceeding, both spouses immediately filed for proportionate liability.[160] He also stated that as a result

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[153]Robinson, *supra* note 145, at 847.

[154]I.R.C. § 6015 includes the following subsections that all deal with fraudulent schemes:

1. I.R.C. § 6015(c)(3)(A)(ii). Taxpayers cannot elect separate liability if the Secretary can demonstrate that a fraudulent scheme involving asset transfers occurred by the individuals filing the joint return.

2. I.R.C. § 6015(c)(4)(A). The transfer of a disqualified asset to an individual increases the portion of the deficiency that individual must pay by the value of the of the disqualified asset. I.R.C. § 6015(c)(4)(B) defines "disqualified assets" as any property or right to property transferred to an individual making the election under this subsection with respect to a joint return by the other individual filing such joint return if the principal purpose of the transfer was the avoidance of tax or payment of tax. I.R.C. § 6015(c)(4)(B)(ii)(I) describes that any transfer made after the date which is one year before the first letter of proposed deficiency from the I.R.S. is received is presumed to have its principal purpose of avoidance of tax or payment of tax.

3. I.R.C. § 6015(d)(3)(C) disallows allocations of deficiency-related items if the Secretary proves that allocation is appropriate because of fraud.

[155]*Id.*

[156]*Id.*

[157]Forrest David Milder, *The Tax Law Provides Significant New Rights to "Innocent Spouses,"* 16 No. 8 MATRIM. STRATEGIST 1 (1998).

[158]*ABA Tax Section Meeting: Divorce Lawyers, Tax Lawyers Split on Election of Proportionate Liability*, 98 TAX NOTES TODAY 149-2, 2 (1998), Doc 98-24338 (4 pages).

[159]*ABA Tax Section Meeting: New Innocent Spouse Law to Generate Regs, Some Confusion*, 98 TAX NOTES TODAY 148-2 (1998), Doc 98-24216 (3 pages).

[160]*See supra* note 159, at 1.

of everyone in a divorce proceeding filing, the I.R.S. would either lose the election or will suspect that there may have been a deficiency on that couple's tax returns.[161]

The most shocking criticism of the new provision is the cost the Treasury will have to bear in implementing the new provision. Critics projected the changes will cost the Treasury $1.406 billion dollars by the year 2007.[162] With the need for Treasury Regulations to aid in interpreting portions of the provision, such as the "knowledge" requirement, it makes one wonder if the changes were worth it or if another proposal would have been more cost effective.

IX. UPDATES

Since the promulgation and enactment of the new "innocent spouse" provision, the I.R.S. has been busy preparing new forms required to be created under I.R.C. § 6015. Pursuant to I.R.C. § 6015(f), the Secretary prepared procedures under which requesting spouses can obtain equitable relief. The procedures to obtain equitable relief are contained within Notice 98-61.[163]

The I.R.S. has also released new versions of the "innocent spouse" relief forms and publications. Pursuant to I.R.C. § 6015, the I.R.S. must set procedures for alerting married taxpayers of their joint and several liability on all appropriate tax publications and also must notify the taxpayers of their right to relief. The new provisions are provided in I.R.S. Publication 971, labeled, "Innocent Spouse Relief."[164] The I.R.S. is also telling taxpayers to use the revised Form 8857, labeled "Request for Innocent Spouse Relief," to request relief.[165]

X. CONCLUSION

The new "innocent spouse" provision, I.R.C. § 6015, allows a greater number of taxpayers to obtain relief from the joint and several liability associated with joint returns. Though critics have already dissected the provision, searching for potential weaknesses, Treasury Regulations will be published to aid courts and the I.R.S. in applying the provision. The magnitude of the provision's effect cannot be measured until the provision is applied to actual cases. And when the provision enables even one more taxpayer to obtain relief, "innocent spouses" like Josephine Berman will be satisfied, acknowledging that the Congress and the I.R.S. worked together effectively to ensure that taxpayers can obtain the relief much deserved and much awaited.

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[161] *Id.* at 3.

[162] Robinson, *supra* note 145, at 849.

[163] *See supra* note 107-11 and accompanying text.

[164] I.R.S. News Release IR-99-06 (January 12, 1999).

[165] *Id.* Both the I.R.S. Publication 971, "Innocent Spouse Relief" and Form 8857, "Request for Innocent Spouse Relief," are available on the I.R.S. Website at www.irs.ustreas.gov. or by calling 1-800-Tax-Form. The Treasury is also encouraging taxpayers to send comments or suggestions for improving the materials to: Tax Forms Coordinating Committee, IRS, OP:FS:FP, Room 5577, 1111 Constitution Ave., NW, Washington., D.C. 20224.

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