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Robert P. Achenbach, Jr.

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Streamlined Equitable Innocent Spouse Relief

-by Robert P. Achenbach, Jr.

A recent case illustrates the streamlined equitable relief available under the innocent spouse rules.

Equitable Innocent spouse Relief

The current innocent spouse relief statute[1] provides for three levels of relief for taxpayers who file joint returns: (1) relief for joint-return filers for understatement of taxes attributable solely to the nonrequesting spouse;[2] (2) limitation of joint liability for requesting taxpayers who are unmarried, separated, or not living together when relief is requested;[3] and (3) equitable innocent spouse relief.[4] The first two provisions do not allow relief for an assessment of unpaid or underpaid taxes not resulting from an erroneous item on a joint return, leaving only equitable relief as to taxes listed on the return but not paid in full.

I.R.C. § 6015(f) grants the IRS discretion to relieve an individual from joint liability, where relief is not available under I.R.C. §§ 6015(b) or (c), if, taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or deficiency. When the liability arises from an underpayment of tax reported as due on a joint return, relief is available only under I.R.C. § 6015(f).[5]

As directed by I.R.C. § 6015(f), the IRS has prescribed procedures in *Rev. Proc. 2013-34*[6] to determine whether a requesting spouse is entitled to equitable relief from joint and several liability. Pursuant to *Rev. Proc. 2013-34*,[7] the IRS is to conduct a multistep analysis when determining whether a requesting spouse is entitled to equitable relief under I.R.C. § 6015(f). The requirements for relief under *Rev. Proc. 2013-34*, are categorized as threshold or mandatory requirements, streamlined elements, and equitable factors. A requesting spouse must first satisfy each threshold requirement to be considered for relief. A reviewing court determines *de novo* whether the IRS has correctly applied the threshold and equitable requirements in each case.[8]

Threshold Requirements

Under *Rev. Proc. 2013-34*, the requesting spouse must meet seven threshold requirements to be considered for relief under I.R.C. § 6015(f).[9] Those requirements are:

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(1) the requesting spouse filed a joint return for the taxable year for which relief is sought;

(2) relief is not available to the requesting spouse under I.R.C. § 6015(b) or (c);

(3) the claim for relief is timely filed;

(4) no assets were transferred between the spouses as part of a fraudulent scheme;

(5) the nonrequesting spouse did not transfer disqualified assets to the requesting spouse;

(6) the requesting spouse did not knowingly participate in the filing of a fraudulent joint return; and

(7) absent certain enumerated exceptions, the tax liability from which the requesting spouse seeks relief is attributable to an item of the nonrequesting spouse.

Streamlined Determination Elements

If the threshold requirements are satisfied, *Rev. Proc. 2013-34*, sets forth the following requirements that a requesting spouse must satisfy to qualify for a streamlined determination granting relief under I.R.C. § 6015(f):

(1) the requesting spouse is no longer married to the nonrequesting spouse on the date the IRS makes its determination;

(2) the requesting spouse will suffer economic hardship if relief is not granted; and

(3) in the case of an underpayment, the requesting spouse did not know or have reason to know that the nonrequesting spouse would not or could not pay the tax reported on the joint return as of the date the return was filed or the date the requesting spouse reasonably believed the return was filed.[10]

Contreras v. Commissioner[11]

In the recent case, *Contreras,*[12] the requesting spouse did not work outside the home and the family income came solely from the former spouse's construction company. Although the couple were married in 2000, the requesting spouse learned in 2004 that the former spouse was already married under common law. The former spouse obtained a divorce of the common law marriage in 2005. Although the couple did not get officially remarried, the requesting spouse obtained a divorce in 2011.

The final divorce decree included a protective provision for the "preservation and protection" of the requesting spouse and her minor children from the former spouse. The divorce decree also provided that the requesting spouse receive a one-half title to an undeveloped parcel of land and the family residence, subject to the tax liens in effect for the 2006 through 2009 unpaid taxes, plus $127,050. The former spouse failed to pay the money and the requesting spouse was awarded a foreclosure judgment that required the former spouse to transfer full title to both properties to the requesting spouse.

Prior to 2006, the former spouse handled all tax matters and paid taxes when due. The couple filed joint returns for 2006 through 2009 in 2013 after the couple had divorced, but the former spouse did not pay the taxes owed. The requesting spouse signed the returns on the advice of counsel hired by the former spouse. The requesting spouse sought equitable innocent spouse relief from the taxes which was denied by the IRS.

Meeting the Threshold Requirements

Of the seven threshold requirements, the only requirement in dispute was whether any assets were transferred between the spouses as part of a fraudulent scheme. The IRS argued that the undeveloped lot and the residence were transferred between the requesting spouse and the former spouse as part of a fraudulent scheme. The requesting spouse argued that no fraudulent scheme existed because the assets were transferred pursuant to a court-ordered divorce decree judgment subject to the IRS liens of record and were therefore not part of a fraudulent scheme.

The court stated that the basic badges of fraud include an intent to misrepresent, conceal, or hide information from a party. The court found that the transfer was made to satisfy a judicial foreclosure due to the former spouse's failure to pay petitioner $127,050 as awarded in the divorce decree. The transfer was recorded publicly and was subject to public inspection. Thus, the court held that there was no intent to misrepresent, conceal, or hide this transaction from the IRS, and the court held that the requesting spouse met all of the threshold requirements.

Meeting the Streamlined Relief Requirements

Marital status. The court found that the requesting spouse met the first requirement because the requesting spouse was no longer married to the former spouse, both when the 2006 through 2009 returns were filed and when the requesting spouse requested relief.

Economic hardship. Under *Rev. Proc. 2013-34*,[13] economic hardship exists if satisfaction of the tax liability, in whole or in part, would result in the requesting spouse's being unable to meet reasonable basic living expenses. The requesting spouse would suffer economic hardship if two tests are met: (1) either (a) the requesting spouse's income is below 250 percent of the federal poverty level or (b) the requesting spouse's monthly income exceeds the requesting spouse's reasonable basic monthly living expenses by $300 or less and (2) the requesting spouse does not have assets from which the requesting spouse can make payments toward the tax liability and still meet reasonable basic living expenses. Although the requesting spouse was unemployed, the IRS argued that (1) the requesting spouse could obtain employment and (2) the requesting spouse could pay the taxes from the sale of the two properties.

The court found that (1) the requesting spouse's income, even if she was able to obtain work, would be less than 250 percent of the federal poverty level, and (2) the proceeds of the sale of the two properties were insufficient to meet the requesting spouse's tax liability and would leave the requesting spouse homeless. Therefore, the court held that the requesting spouse met the economic hardship requirement.

Knowledge. Under *Rev. Proc. 2013-34*,[14] knowledge exists when the requesting spouse knew or had reason to know the nonrequesting spouse would not or could not pay the tax liability at the time of filing the joint return. Factors considered when determining whether the requesting spouse knew or should have known the nonrequesting spouse would or could not pay the tax liability include:

(1) the requesting spouse's level of education;

(2) any deceit or evasiveness of the nonrequesting spouse;

(3) the requesting spouse's degree of involvement in the activity generating the tax liability or the household or business finances;

(4) the requesting spouse's business or financial expertise; and

(5) the presence of lavish or unusual expenditures relative to past spending levels.

If the requesting spouse had knowledge that the nonrequesting spouse would not or could not pay the taxes, that knowledge may be negated if the nonrequesting spouse abused the requesting spouse or maintained control of the household finances by restricting the requesting spouse's access to financial information such that the nonrequesting spouse's actions prevented the requesting spouse from questioning or challenging payment of the tax liability. A requesting spouse must establish that the requesting spouse: (1) was the victim of abuse before the return was filed and (2) as a result of that abuse, was not able to challenge the treatment of any items on the return or was not able to question the payment of any balance due reported on the return, for fear of the nonrequesting spouse's retaliation.

The court found that the requesting spouse had provided sufficient evidence that the nonrequesting spouse had physically and mentally abused her to the point of forcing her from the home and requiring her to include a protection clause in the divorce decree. Thus, although the IRS demonstrated that the requesting spouse had some knowledge of the nonrequesting spouse's financial difficulties, that knowledge was negated by the abuse suffered by the requesting spouse.

Conclusion

Even though this case demonstrated how a requesting spouse may make use of the streamlined equitable relief, the requesting spouse still had to meet over a dozen requirements to obtain relief. Taxpayers may still obtain equitable relief through the final set of factors provided in *Rev. Proc. 2013-34*,[15] but careful and thorough documentation of the streamlined factors will save the taxpayer that extra effort.

ENDNOTES

[1] I.R.C. § 6015. For discussion of the other innocent spouse relief provisions, see Harl and Achenbach, *Agricultural Law*, § 26.10 (2019).

[2] I.R.C. § 6015(b).

[3] I.R.C. § 6015(c).

[4] I.R.C. § 6015(f). Equitable innocent spouse relief is also governed by Rev. Proc. 2013-34, I.R.B. 2013-43, 398.

[5] See I.R.C. § 6015(b)(1)(B), (c)(1), (f)(1).

[6] See § 4, I.R.B. 2013-43 397.

[7] See § 4, I.R.B. 2013-43 397.

[8] Contreras v. Comm'r, T.C. Memo. 2019-12.

[9] I.R.B. 2013-43 397.

[10] Rev. Proc. 2013-34, § 4.02, I.R.B. 2013-43 397.

[11] T.C. Memo. 2019-12.

[12] T.C. Memo. 2019-12.

[13] I.R.B. 2013-43 397.

[14] I.R.B. 2013-43 397.

[15] I.R.B. 2013-43 397.

CASES, REGULATIONS AND STATUTES

BANKRUPTCY

CHAPTER 12

PLAN. The debtors, husband and wife, filed for Chapter 12 their plan proposed payments of unsecured claims over five years, followed by formation of a trust funded with farm equipment, inventory and products. The debtors would transfer the farm property to themselves as trustees and pay the remaining unsecured claims during the next five years. The trustee objected to this plan provision as violating the five year limitation on plan payments under Section 1222(c). The debtors argued that Section 1227(b) allows the estate's property to vest in the debtor at confirmation or as the court otherwise orders. The debtors asserted that conveying the estate's property to themselves as trustees has the legal effect of equitably transferring it to the creditors and that the debtors are paying the unsecured claims by using estate property in the trust to make the second five-year tranche of payments. The debtors argued that Section 1225(b)(7) allows a debtor to propose to pay a claim with property of the debtor or the estate; Section 1222(b)(8) allows the debtor to sell property and distribute the proceeds to creditors having an interest in the property or, in the alternative, to distribute property to the respective interest-holders in kind; Section 1222(b)(10) provides that the estate's property can vest in the debtors or "any other entity" at confirmation or "at a later time;" and Section 1222(b)(12) allows any other plan provision that is "not inconsistent" with the provisions of title 11. The court noted that, although Chapter 11 provides specifically for creditors' trusts and Chapter 12 has no similar provision, Section 1222(b)(10) allows the vesting of estate property in "any other entity." Thus, the court held that the creation of the trust at the termination of the five year plan was not prohibited under bankruptcy law. However, the trustee also argued that the use of the trust violated the five year plan limit under Section 1222(c). The court noted that Section 1222(c) has only two statutorily-prescribed exceptions: (1) Section 1222(b)(5) provides for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due and (2) Section 1222(b)(9) provides for payment of allowed secured claims consistent with Section 1225(a)(5), over a period exceeding the period permitted under Section 1222(c). The court held that neither exception applied in this case; therefore, the use of the trust to extend the plan payments beyond the five year limit was not permissable and the plan could not be confirmed. ***In re* Duensing, 2019 Bankr. LEXIS 598 (Bankr. D. Kan. 2019)**.