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Beware IRS Pushback On Innocent Spouse Relief

If your spouse—current or ex—squirreled money away in Switzerland or didn't report consulting fees or gambling winnings, is it your tax problem too? If you filed joint tax returns the answer is yes, and that can be painful—financially and otherwise. Who's innocent or guilty may seem irrelevant given today's no-fault divorce.

Yet when it comes to the IRS, it counts big-time. If you're married, you don't have to file joint tax returns but most people do. In fact, only about 5% of married taxpayers file separately. It's worth thinking critically about this. See Consider Tax Filing Status Carefully.

After all, by filing jointly, you are both ***fully*** liable, even if your spouse earned 100% of the income and handled all the finances. If your spouse dies, goes to prison, flees the country, or simply divorces you and disappears with no forwarding address, you can be left holding the bag. Your spouse could take 100% of the income and disappear, leaving you with 100% of the tax.

War of the Roses? If you do file jointly, you might later claim innocence, but that label is not easy to get. You can make an innocent spouse claim while you're still married, but innocent spouse claims are most common when a couple was married at tax time but later divorced.

Start by filing an IRS Form 8857 Request for Innocent Spouse Relief. You must show that the tax was due to your spouse. Plus, you must show that when you signed the return you didn't know—and had no reason to know—of the problem. Taking into account all the facts and circumstances, it must be unfair to hold you liable.

Much of the IRS's focus is on just how innocent you seem. You won't fare well if you were an active participant in the problems. If you reasonably ***should*** have known—perhaps your spouse was always away on gambling junkets or bought you lavish gifts far beyond his means—you may not be so innocent after all.

Timing matters too. Lately, the IRS is obsessed with timing. The innocent spouse ***statute*** (Section 6015(f)) doesn't speak to timing, but IRS Regulations say you must claim innocence within two years after the IRS first tries to collect a tax debt. But there's a broader "equitable relief" provision in the tax code. The U.S. Tax Court, which is normally the first court to which a taxpayer has recourse to dispute a tax deficiency, has used that route to give some late-filing spouses a ticket to innocence.

The IRS is adamant about the two years and is appealing these Tax Court cases. The IRS prevailed on the Seventh Circuit Court of Appeals to reverse the Tax Court in *Lantz v. Commissioner*. Nevertheless, the Tax Court held another late filing—but putatively innocent—spouse to be innocent in *Hall v. Commissioner*. The IRS has vowed to keep fighting. See IRS Chief Counsel Notice CC-2009-012.

The IRS won the latest round. The Tax Court ruled a spouse innocent in *Manella v. Commissioner*, 132 T.C. No. 10 (2009). The Third Circuit reversed the Tax Court to side with the IRS in *Mannella v. Commissioner*, No. 10-1308 (3d Cir. 2011). Like the Seventh, the Third Circuit upheld the regulatory requirement that innocent spouse claims ***must*** be made within two years of the IRS commencing collection action.

But a spirited dissent suggests there will be more on this issue and additional jockeying over what "I'm innocent!" claims are time barred. If possible, avoid the timing fuss and stick to the two-year deadline. And where appropriate, consider keeping assets and tax returns separate.

For more about innocent spouse relief see:

When An Innocent Spouse Seeks Tax Relief

IRS Publication 971, Innocent Spouse Relief

IRS Innocent Spouse Questions & Answers

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