Taxing Innocent Spouses: 10 Things You Should Know

By Robert W. Wood

When a married couple files joint tax returns but is delinquent in paying taxes, which spouse is liable? Each person is liable (jointly and severally) for the full amount. Nevertheless, if you have the right facts, you might be considered an "innocent spouse" and owe nothing. But convincing the Internal Revenue Service isn't easy.

What sort of spouse is innocent? You'd better have appealing facts. For example, a 70-year-old disabled and retired nurse was innocent when, after her husband's death, she discovered his financial mess. Her lawyer husband had handled all the family finances and had all tax bills and other bills sent to the Post Office, where he would then pick up the mail. To help pay off the debts, the poor widow sold the house, her possessions and moved into a trailer. Collecting more of the debt from her, the court concluded, would be an unfair economic hardship.

Here are 10 things you should know about getting innocent spouse relief.

You Don't Have to Comingle Assets When You Marry: You can keep assets separate, and have a pre- or post-nuptial agreement (or both). You can also file separate tax returns. However, if you're married, you probably file joint tax returns. IRS statistics show that only about 6 percent of married people file "married filing separately" status.

Tax Rate Impact: In terms of your annual tax liability, you are generally significantly better off if you file jointly, particularly if your earnings are unequal. You can always calculate it both ways (or have your return preparer do so) before you decide. Your filing status (married filing separate or married filing jointly) can't be changed in an amended tax return, so consider it carefully before you file.

Joint and Several Liability: If you file jointly, the liability is "joint and several." That means that the IRS can come after either one of you for 100 percent of the tax debt. Even if your spouse earned 100 percent of the income, each of you is fully liable regardless of who earned what. If your spouse dies, goes to prison, flees the country, or simply divorces you and disappears, you are fully liable.

Plus, the joint liability extends not merely to whatever you put on your tax return. It also covers whatever else turns up that may not have been disclosed on the return you signed. It behooves you to know whether your spouse has any past tax problems and to keep tabs on any tax problems he or she might generate during your marriage.

Claiming Innocence: Most often, innocent spouse claims arise when a couple was married at tax time but later divorced. However, you can make an innocent spouse claim while you're still married. If the IRS is trying to collect taxes from you that you think are really your current or former spouse's problem, you must speak up. Taxpayers claiming they didn't know what their spouse was doing often file for innocent spouse relief.

File Form 8857: You generally start the process by filing an IRS Form 8857, Request for Innocent Spouse Relief. You are requesting a separate tax liability distinct from your current or former spouse. You must show not only that the understated tax on your joint return was due to erroneous items of your spouse, but also that when you signed the return you did not know — and had no reason to know — of the understated tax. In addition, you must demonstrate that taking into account all the facts and circumstances, it would be unfair to hold you liable.

Case-by-Case Determination: The IRS will evaluate what is fair under the circumstances, and that is quite subjective. The IRS will evaluate your case, taking into account your financial situation and that of your spouse (or former spouse); your educational background and business experience; the extent to which you participated in the activity that resulted in the erroneous item; the nature of the erroneous item and its amount relative to other items on your return; if you failed to ask before signing the return about items on (or omitted from) the return that a reasonable person would question; and if the erroneous item was a departure from a recurring pattern on prior years' returns (for example, if it omitted income from an investment regularly reported on prior years' returns).

If You Knew or Participated, Watch Out: Even if you meet the requirements of innocent spouse relief, your request will not be granted if:

Your spouse transferred property to you to avoid paying tax.

The IRS proves you and your spouse transferred assets to one another as part of a fraudulent scheme (e.g., to defraud the IRS or a third-party, such as a creditor, ex-spouse, or business partner).

When a married couple files joint tax returns but is delinquent in paying taxes, which spouse is liable?

The IRS proves that at the time you signed your joint return, you had actual knowledge (or a reason to know) of erroneous items that were allocable to your spouse.

Fundamental Fairness: The relative equities and what looks fair are very important. The IRS evaluates whether under all the circumstances, it is inequitable to hold you liable for your spouse's tax problems. The IRS can consider the waterfront, including: Did you suffer abuse during your marriage? Did you significantly benefit (above normal support) from the unpaid taxes? Are the taxes really attributable to your spouse or ex-spouse? Did you believe your spouse would pay the taxes on the original return? Are you still married to that spouse? Did you know about the items changed in the audit? Will you be able to pay for basic living expenses like food, shelter, and clothing (or otherwise face hardship) if you are required to pay the tax?

Timing Matters: If you want to claim innocent spouse relief you must generally do so within two years after the IRS first tries to collect a tax debt. That first collection activity might be an IRS notice of intent to levy, or something more innocuous such as a notice from the IRS that offsets a refund from another tax year.

The statute seems to dictate filing your claim within two years, and this is the IRS position. But the U.S. Tax Court has allowed some late claims for equitable relief under another provision, Internal Revenue Code Section 6015(f). The IRS is still fighting this issue, and there will probably be additional cases about timing and what claims are barred. If you want to be ruled "innocent," comply with the two-year deadline if you can.

Going to Court: If you can't convince the IRS you're innocent, you can go to U.S. Tax Court. The IRS has long maintained that the courts can only decide if the IRS made a "reasonable" decision or abused its discretion. But taxpayers have claimed (and the U.S. Tax Court has agreed) that the court can take a *fresh* look at the case based on facts the IRS may not have considered. That could lead to more spouses getting relief. On the whole, though, getting innocent spouse relief is tough, and the standards are high.

This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.

Robert W. Wood practices law with Wood & Porter, in San Francisco (www.woodporter.com), and is the author of *"Taxation of Damage Awards and Settlement Payments"* (4th Ed. 2009), "*Qualified Settlement Funds and Section 468B*" (2009), and "*Legal Guide to Independent Contractor Status*" (4th Ed. 2007), all available at www.taxinstitute.com.