April 17, 2012

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Proposed Changes to the Guidelines for Innocent Spouse Relief in Revenue Procedure 2003-61

Dear Commissioner Shulman:

Enclosed are comments on the proposed changes to the guidelines for innocent spouse relief in Revenue Procedure 2003-61. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

[Signature]

William M. Paul
Chair, Section of Taxation

Enclosure

cc: Emily S. McMahon, Assistant Secretary (Tax Policy), Department of the Treasury
William J. Wilkins, Chief Counsel, Internal Revenue Service
These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Tamara Borland and Kathryn Sedo of the Low Income Taxpayer Committee of the Section of Taxation. Substantive contributions were made by Paul Harrison, Mary Gillum and Susan Morgenstern of the Low Income Taxpayer Committee. Additional comments were made by committee members Jamie Andree, Jan Pierce, Carlton Smith, Christine Speidel and George Willis, Vice Chair of the Committee. The Comments were reviewed by T. Keith Fogg, Committee Chair. The Comments were further reviewed by Sharon Stern Gerstman of the Section’s Committee on Government Submissions and by Alice G. Abreu, Council Director, for the Low Income Taxpayer Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contacts:  
Tamara Borland  
Phone: (319) 338-3369  
Email: tborland@iowalaw.org

Kathryn Sedo  
Phone: (612) 624-5813  
Email: sedox001@umn.edu

Date:   April 17, 2012
EXECUTIVE SUMMARY

On January 23, 2012, the Internal Revenue Service (the “Service”) issued Notice 2012-8, which proposes revisions to the guidelines regarding equitable relief from income tax liability under section 66(c) and section 6015(f) of the Internal Revenue Code contained in Rev. Proc. 2003-61.

Rev. Proc. 2003-61 was issued following enactment of the Internal Revenue Service Restructuring and Reform Act of 1998 Title III §3201(a), which sets forth the circumstances under which a spouse may be relieved from part or all of the liability that arises from filing a joint tax return.

The proposed revisions contain ten significant changes to the guidelines for granting innocent spouse relief. We believe that for the most part these changes serve to help those who seek innocent spouse relief, with some exceptions as noted in our comments.

We commend the Service for revisiting these guidelines. We believe that the proposed guidelines provide an improved framework for determining eligibility for innocent spouse relief under section 6015(f) and will result in a more complete and equitable evaluation of each claim for relief. We appreciate the complexity of the issues and the difficulty of analyzing all the information, especially given that many individuals requesting innocent spouse relief are unrepresented and may have difficulty in gathering relevant information. We also appreciate the Service being sensitive to the concerns raised by domestic abuse advocates and by our Committee.

COMMENTS

I. Comments on the Significant Changes.

The Notice proposes ten significant changes to the guidelines for granting innocent spouse relief. Each of these is outlined and discussed in turn below.

(1) Elimination of the Two-Year Rule under Section 6015(f).

The proposed change to section 4.01(3) of the revenue procedure will make clear that a request for innocent spouse relief is timely so long as the claim for relief is made within the collection statute of limitations, and not the “two-year rule” used for determining timeliness under sections 66(c), 6015(b) or 6015(c).

We applaud this change, but note that it would be useful to specifically reference the Collection Statute Expiration Date (“CSED”) in the revised revenue procedure. This is the nomenclature used in other documents that the taxpayer may receive, such as a Tax Account

1 2012-4 I.R.B.309.
2 References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.
Transcript, and we feel that consistency in the nomenclature will aid unsophisticated taxpayers.

(2) **Expansion of Relief in Cases of Fraud by Non-Requesting Spouse.**

The change to section 4.01(7)(e) broadens the relief that can be granted with respect to taxes owed by the requesting spouse in circumstances where the fraud of the non-requesting spouse gave rise to the understatement of the tax or deficiency.

We support this change. Note that in section 3.02 of the Notice, the overview of the change appears to be missing the word “except” and should read “…that the income tax liability must be attributable to an item of the non-requesting spouse, *except* when the non-requesting spouse’s fraud gave rise to the understatement of tax or deficiency.” (Emphasis added.)

(3) **Expanded Streamlined Determinations to Include Section 66(c) and Both Understatement and Underpayment Cases.**

Proposed new section 4.02 expands the circumstances under which the Service will make streamlined determinations to understatements of tax in addition to underpayments and to requests for equitable relief under section 66(c).

We welcome the clarification that these procedures will apply to both underpayment and understatement of tax cases and the specific inclusion of section 66(c) cases in the streamlined review process. However, we believe that the “knowledge test” under proposed new section 4.02(3) will limit the number of cases that qualify for streamlined determination. We propose that the knowledge standard be rewritten so that the Service may consider all evidence that a requesting spouse presents concerning knowledge, and then list the guideline factors currently enumerated in the section. By listing some, but not all, possible factors concerning knowledge we fear that the Service will not consider factors that are not specifically enumerated. Other factors include ignorance about the effect of signing a return, mistaken beliefs that married individuals must file a joint return, and lack of the opportunity to review a return due to e-filing by the non-requesting spouse. Returns may be filed jointly solely to obtain credits or benefits not available to those who file separate returns and these incentives in the Code can drive the decision to file jointly. Therefore, we recommend that the Service consider all events surrounding the signing of a joint return when analyzing the case under the “knowledge” standard and that the specific language of proposed new section 4.02(3) make it clear that all such evidence may be considered.

(4) **Clarification That No Single Factor Controls the Determination.**

In section 4.03(2), the proposed revenue procedure clarifies that no one factor or a majority of factors dictates the outcome of a request. While we agree that there must be room for a broad consideration of the equities, we have concerns that this will prove difficult to administer with consistency. We propose a slightly different approach.

The current practice (at least among Tax Court judges) is to compare the number of factors in favor of relief, with the number of factors weighing against relief. If more factors weigh
in favor than against, relief is granted. If more factors are negative than positive, relief is denied. This can lead to inequitable results, as it does not permit a full consideration of the requesting spouse’s circumstances. We are concerned, however, that it may be difficult for those accustomed to the current Tax Court approach to stop counting up factors.

We propose a three step evaluation process. The first step is the streamlined analysis in section 4.02 of the proposed revenue procedure. Where a case does not qualify for streamlined review, or if the streamlined review produced a negative determination, the caseworker would move to the second step. Our proposed second step is the current Tax Court approach, i.e., to make a “scorecard” evaluation of the factors listed in section 4.03. If more factors weigh in favor of relief than against, the Service would grant relief.

If a favorable decision is not reached at this second step, the Service should consider the totality of the taxpayer’s circumstances. This is the approach advocated by the proposed revenue procedure in section 4.03(2). At the third step, the reviewer would exercise discretion to weigh the equities of the requesting spouse’s situation, as proposed in section 4.03(2). This would facilitate a complete review of the taxpayer’s request for relief.

This sequential analysis balances the need for consistency and administrative efficiency with the equitable purpose of section 6015(f).

(5) Changes to Economic Hardship Analysis.

The change to section 4.03(2)(b) includes using national financial standards used in collection cases and refers to the Federal poverty guidelines.

We applaud this revision because the financial standards are known and we believe will result in a more uniform analysis of what constitutes economic hardship. Making economic hardship a neutral factor in the non-streamlined cases is also a welcome change.

(6) Actual Knowledge Not Given Added Weight and Abuse Factors.

Under new section 4.03(2)(c)(i), actual knowledge of the item giving rise to an understatement or deficiency will no longer be weighed more heavily than other factors. This is a welcome change, particularly in underpayment cases. The Committee agrees that this is a factor to be taken into account but that it should not be dispositive.

Additionally, under new section 4.03(2)(c)(ii), abuse or financial control that restricts access to financial information or prevents challenges to the treatment of items on the joint return are factors that weigh in favor of relief even if actual knowledge of the items giving rise to the understatement or deficiency exists.

We welcome both changes based on our experience that there can be cases where it is not feasible for a requesting spouse to question the treatment of items on a return or the non-requesting spouse's ability and willingness to pay any taxes shown. However, we are very concerned that abuse as a separate factor (it is now included only as a component under the
knowledge test) has been eliminated, as abuse can impact more factors than just knowledge. Therefore, as set forth more completely below, the Committee recommends that abuse continue to be a separate factor for consideration in non-streamlined determination cases.

We are also concerned that the examples contained in section 4.03(2)(c) do not take into account cultural differences in reporting abuse. The Service should recognize that some cultures shun disclosing what they consider “private matters” to police, doctors, therapists, spiritual advisors, family or friends. As discussed in detail in the National Taxpayer Advocate’s 2012 Annual Report, wide cultural differences in gender equality exist and can create a hostile environment towards women, causing women not to report abuse. These differences require recognition to fully capture abuse situations. Additionally, the Service should develop careful screening questions to identify behavior and treatment by which the non-requesting spouse may control the requesting spouse’s access to tax information.

(7) Reasonable Expectation of Payment.

Section 4.03(2)(c)(ii) states that the Service will consider whether the requesting spouse reasonably expected that the non-requesting spouse would pay the tax within a reasonably prompt time after filing of the joint return. While the proposed standard is an improvement over the current standard, this change still fails to address the reality that many provisions in the Code drive taxpayers to file a joint return and administrative practices can foster the same result. Many unsophisticated married taxpayers simply have no idea that they may file separately. Alternatively, joint filing may be driven out of necessity to claim certain credits, most notably the Earned Income Tax Credit (“EITC”), which cannot be claimed if a taxpayer’s status is married filing separately. Return preparers routinely use joint return status to achieve the lowest possible liability without explaining the potentially negative consequences of filing jointly without payment.

With the increased use of e-filing, a requesting spouse may have implicitly agreed to the filing of a joint return but have no knowledge that tax is not being paid.

Additionally, many of the Service’s collection alternatives (e.g. Currently Not Collectible status, Offers in Compromise or Installment Agreements) require that all past returns be filed. Taxpayers seeking collection relief file these past due returns quickly to achieve immediate collection relief without considering the long term consequences of their decision to file a joint return.

For all of the reasons mentioned above, the Committee suggests that in underpayment cases decided under section 4.03 of the proposed revenue procedure, the knowledge factor be neutral absent indications that the requesting spouse dissipated funds set aside to pay the taxes. Alternatively, the Service should be willing to consider other mitigating evidence provided by the requesting spouse which might make this factor neutral or favorable, including evidence consistent with the examples listed above.

If the Service is unwilling to make expectation of payment a neutral factor in underpayment cases for the reasons set out above, then we suggest that the Service clarify that
entering into an installment agreement to pay the tax would satisfy this standard.

(8) **Legal Obligation Factor.**

Proposed section 4.03(2)(d) clarifies that the legal obligation of the requesting spouse to pay the tax is a factor to be considered and will only be a negative factor if the tax is the sole legal obligation of the requesting spouse. That the tax debt is the sole legal obligation of the nonrequesting spouse is a positive factor for relief, and is neutral in all other circumstances. The Committee suggests that a requesting spouse be able to provide additional information to rebut either a negative or neutral determination of this factor, if appropriate, as in our experience family law attorneys and judges are very unsophisticated about the tax consequences of divorce decrees and agreements. For example, even if there is no legal separation or the tax debt is not mentioned in the divorce decree, a document from the nonrequesting spouse taking responsibility for such debt should be a positive factor favoring relief.

(9) **Tax Compliance.**

Section 4.03(2)(f) specifies that a requesting spouse’s subsequent compliance with tax laws is a factor that will weigh in favor of relief. While we feel that this is a salutary addition, we believe that there should be guidance in cases where non-compliance may be excusable. For example, many requesting spouses delay filing subsequent returns for fear that their refunds may be taken to offset the tax of the non-requesting spouse. Further, many taxpayers have no filing obligation or do not owe any additional taxes. This should be taken into account when considering compliance. Spousal abuse (including psychological harm or trauma) should be taken into account as a valid reason for non-compliance, and non-compliance for that reason should not be a factor weighed against the requesting spouse.

(10) **Expanded Refund Relief.**

Revised section 4.04 broadens the availability of refunds in deficiency cases. We welcome this proposed revision. As outlined in greater detail below, however, we suggest that payments from joint accounts (or from joint refunds) should be allocated to the requesting spouse if the funds used to pay the taxes came from the requesting spouse (or if the joint refund was the result of overpayments by the requesting spouse).

**II. Additional Comments on Streamlined Determinations in Section 4.02.**

Revised section 4.02 of the proposed revenue procedure creates guidance for streamlined determinations and expands relief to both understatement and underpayment cases. We generally support these changes and submit the following brief additional comments:

(1) The marital status provision has not changed. We note that the requirement of divorce, legal separation, or 12-month separation frequently results in ineligibility for streamlined determinations as many couples remain together solely for economic reasons. Low-income couples confront resource issues when separating or seeking marriage dissolution, including the cost of divorce. Economic barriers, such as difficulties obtaining alternative subsidized housing,
force them into situations that appear inconsistent with a dissolved relationship.

(2) The economic hardship standard has been clarified. We would like to see further clarification with regard to assets owned by the requesting spouse, as outlined in the additional comments on section 4.03 below.

(3) With regard to changes in the knowledge test, inclusion of evidence of abuse or financial control is a welcome revision. We also believe that in underpayment cases, the proposed standard of payment within a reasonably prompt time is an improvement. However, we suggest that the revenue procedure clarify the impact of installment agreements and returns filed only as a result of the Service’s enforcement and collection activities. As explained above, we again urge the Service to consider all circumstances surrounding the signing of a joint return when considering whether the requesting spouse should be relieved of liability. A more complete discussion of other situations where the application of the knowledge test could be improved is in the additional comments on 4.03 below.

III. Additional Comments on Factors for Determining Relief under Section 4.03.

(1) Marital Status.

Whereas most of the revisions found in the proposed revenue procedure provide somewhat expanded access to relief, the determination of marital status provision in section 4.03(2)(a)(iv) adds a hurdle to obtaining relief, where the requesting spouse does not qualify as no longer married under section 4.03(2)(a)(i)-(iii). Because this provision makes it more difficult to qualify for relief, it appears inconsistent with the objective of the Notice. To be considered no longer married, under section 4.03(2)(a)(iv), the requesting spouse cannot have been “a member of the household at any time during the 12-month period ending on the date relief was requested.” Previously, a 12-month separation was only required when seeking equitable relief for underpayments under section 4.02(1)(a).

The length of separation may be dictated by numerous factors including economic circumstances or abuse. We recognize that a brief separation immediately prior to making a request for relief could occur in an effort to “game” consideration for relief; however, this concern could be ameliorated by looking at continued separation subsequent to the making of the request. The Service should not make relief more difficult by imposing a 12-month separation requirement. We suggest that the Service should find that this factor favors relief if the spouses are separated as of the date the relief is requested and remain separated as of the Service’s determination. This factor should remain neutral if the requesting spouse is not living separately from the non-requesting spouse as of the date of filing of the request for relief and during the pendency of the request for relief. The “living separately” determination should include those arrangements where spouses or former spouses may share the same abode but may live separate lifestyles because they are no longer a marital unit.
(2) Economic Hardship.

The guidance concerning economic hardship first looks to income and expenses in determining whether there is economic hardship. The Committee suggests that economic hardship be presumed when the requesting spouse’s household income is less than 250% of the poverty guidelines and when the requesting spouse’s assets are less than the thresholds set in section 6334(a)(1)-(3). This would streamline the determination of this factor. If the requesting spouse’s household income is higher than 250% of the poverty level, then he or she would be required to provide proof of expenses to determine if economic hardship exists. If the requesting spouse has assets greater than the thresholds set in section 6334(a)(1)-(3), then the Service should consider the liquidity of the assets, the financial burden(s) that may arise from liquidating assets, and the impact of liquidating these assets on the requesting spouse’s ability to meet basic living expenses. For instance, if the requesting spouse has a retirement plan, liquidating this asset may subject the requesting spouse to both an excise tax under section 72(t) and income tax, further reducing the household income available to pay expenses. Real estate owned in an economically depressed area takes significant time to sell, often requires expenditures to ready the property for sale, and may cause income tax issues. If the assets are not sufficiently liquid then the Service should find that an economic hardship would occur.

(3) Knowledge or Reason to Know.

Section 4.03(c)(ii) sets forth facts and circumstances where the requesting spouse will be found not to have had a reasonable belief that the tax debt would be paid when the tax return was filed or within a reasonably prompt time after filing the joint return.

Unfortunately, there are no illustrations of when the requesting spouse will be found to have had a reasonable belief that the tax due would be paid. There is, however, guidance concerning the factors that weigh against relief, for example, knowledge of past financial difficulties of the non-requesting spouse. We believe that a more nuanced analysis is appropriate under this test. For example, we often encounter situations where the non-requesting spouse had financial difficulties in the past, but more recently has demonstrated financial responsibility. In dealing with the Service, we find that many innocent spouse caseworkers will consider the requesting spouse tainted if he or she knew of any financial difficulties – no matter how far in the past. One place where the Service should look to the past is in situations where the non-requesting spouse has previously entered into payment arrangements with the Service (or other creditors) and has successfully completed such arrangements. In those cases, it would be reasonable for the requesting spouse to believe that the tax would be paid. Under these types of circumstances, the knowledge or reason to know relating to underpayment should be found in favor of relief or should be considered neutral.

Subsection (iii) lists additional “reason to know” factors. We note that because many married couples do not understand the ramifications of filing a joint return or believe incorrectly that because they are married and living together that they must file a joint return, an additional factor should be added to this section that would weigh in favor of relief in circumstances where the requesting spouse reasonably believed that a joint return was required. As practitioners, we have seen instances where joint returns were mistakenly filed in situations where the Service
required compliance before granting relief from collection activities, where state courts have ordered the parties to file joint tax returns as part of divorce proceedings, and other situations involving mistake. In these circumstances, the taxpayers may file a joint return without any ability to pay, at the request of the Service or a state court, without realizing the consequences.

Section 4.03(c)(iv) enumerates common forms that abuse may take. This more expansive definition is helpful. In dealing with innocent spouse caseworkers in the past, the absence of a police report has been a serious impediment to finding abuse. This section should affirmatively state that the absence of a police report should not automatically prove that there was no abuse. Self-reporting, statements from family, friends, and co-workers, and findings of state courts and service providers should be considered in evaluating whether abuse took place.

We also recommend that section 4.03(c)(iv) be set out as an eighth factor, as new section 4.03(h). The current draft places abuse under the knowledge or reason to know test; however, the language of the paragraph itself purports to relate to the overall determination and interacts with many factors. We believe that the impact of abuse would be clearer if it were set forth as an independent factor to be considered.

(4) **Significant Benefit.**

Section 4.03(e) explains that when the requesting spouse is considered to have enjoyed the benefits of living a lavish lifestyle, such as owning luxury assets and taking expensive vacations, these circumstances demonstrate significant benefit weighing against relief. The guidance refers to “owning” luxuries or taking expensive vacations. A better measure of significant benefit would be the *purchase* of luxuries following the filing of joint returns for the years that are the subject of the innocent spouse request. Past *lifestyle* should be irrelevant to the determination of significant benefit.

In addition, the Service should provide more guidance as to what is considered a “luxury” item. Practitioners have experienced circumstances where the Service has argued that recreational equipment such as a small fishing boat should be considered a luxury item. Given that viewpoints may vary greatly as to what is considered a luxury item, it would be helpful to establish guidelines. We propose that items that may be considered “recreational” in nature not be considered a luxury if the items are valued under $10,000 in the aggregate. Further, we recommend that this dollar amount be adjusted on a yearly basis.

(5) **Compliance with Tax Laws.**

Section 4.03(f) discusses the factor of compliance with income tax laws. Sections 4.03(f)(1) and (3) provide, “If the requesting spouse made a good faith effort to comply with tax laws but was unable to fully comply, then this factor will be neutral.” In addition to the example listed (where a taxpayer files but is unable to pay due to financial circumstances), failure to file because the refund would be used to pay obligations in dispute during the pendency of the innocent spouse claim should also be considered a neutral factor. If the non-filing is due to fraud or bad intentions then this factor should weigh against granting relief.
(6) **Mental or Physical Health.**

Under section 4.03(g), mental and physical health is a factor that may be considered. The Service will look to whether the requesting spouse was in poor health at the time of filing of the joint return or the request for innocent spouse relief. A taxpayer's health may change during the pendency of the request for relief; therefore we would add that requesting spouses should also be allowed to provide updated health information subsequent to the filing of the request for relief.

(7) **Other.**

Finally, we encourage the Service to look at additional facts which would favor granting equitable relief. For example, under the financial analysis and economic hardship factor, costs of caregivers for an elderly parent or disabled child should be taken into consideration. Also, private school tuition may not be a “luxury” item for a child with special needs. A catch-all or miscellaneous factors section that allows the Service to consider all reasonable factors not otherwise enumerated elsewhere would comport with the equitable purpose of Section 6015(f).

**IV. Refunds.**

Section 4.04 concerns the ability of the requesting spouse to receive refunds of payments made by the requesting spouse.

Under Section 4.04, joint payments are not eligible for refund. However, the Service does not discuss what constitutes a joint payment. If the requesting spouse made a payment with funds from a joint account but supplied the funds to that account, then the refund should be considered a separate payment made by the requesting spouse. Similarly, if joint refunds are used to pay down the liability, a refund of the portion of the joint refund payment would be appropriate if it can be shown that the refund was due to the requesting spouse’s overpayment of tax.