COMMENTS ON THE SECTION 6015 PROPOSED REGULATIONS

The following Comments are the individual views of the members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.

These Comments were prepared by individual members of the Section of Taxation, Domestic Relations Committee. Principal responsibility was exercised by Cindy Lynn Wofford. Substantive contributions were made by Kelly J. Capps. The comments were reviewed by Alfred C. Groff, as a member of the Section's Committee on Government Submissions and by Robert E. McKenzie, Council Director for the Domestic Relations Committee.

Although members of the Section of Taxation who participated in preparing these comments have clients who would be affected by the federal tax principles addressed by these comments or have advised clients on the application of such principles, 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.

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Summary

The following comments are comments to the proposed regulations under section 6015 of Internal Revenue Code of 1986, as amended (the “Code”). Section 6015 was added to the Code by the IRS Reform Act, P.L. 105-206. The proposed regulations appeared in the Federal Register on January 17, 2001 (REG-106446-98).

The first comment points out a conflict between certain statutory language and the underlying proposed regulation. The remaining comments identify certain terms and phrases used in the proposed regulations which are inconsistent with state domestic relations laws or other Code provisions. The comments also note where additional examples would be helpful to illustrate the application of the proposed rule.


The rule expressed in section 1.6015-2(a)(3) of the proposed regulations is, on its face, at variance with the statutory language of section 6015(b)(1)(C), which sets forth the third requirement for innocent spouse relief. In addition, the proposed rule appears to be inconsistent with the preamble of the proposed regulations.

According to section 6015(b)(1)(C), the requesting spouse must establish that in signing the return he or she “did not know, and had no reason to know” of the understatement. This language is virtually identical to language in former section 6013(e)(1)(C). Section 1.6015-2(a)(3) of the proposed regulations interprets section 6015(b)(1)(C) to require the spouse to establish that he or she “did not know and had no reason to know of the item giving rise to the understatement”. Section 1.6015-2(c) of the proposed regulations goes on to discuss the test under section 6015(b)(1)(C) in terms of actual and constructive knowledge of items. However, the generally accepted standard in omitted income cases under former section 6013(e)(1)(C) was knowledge of the underlying transaction that gave rise to the item, not knowledge of the item. Several circuits also applied a knowledge-of-the-underlying-transaction test in erroneous deduction cases. Query whether 1.6015-2(a)(3) of the proposed regulations expresses a new knowledge standard under section 6015(b)(1)(C) or whether it simply uses different language to express the same standard. The preamble to the proposed regulations states that case law interpreting language under former section 6013(e)(1)(C) will be used to interpret the same language under section 6015. It would thus appear that 1.6015-2(a)(3) of the proposed regulations retains the same standard but expresses it differently. In that case, the Secretary may wish to avoid possible confusion by clarifying this point.


Section 1.6015-2(d) of the proposed regulations sets forth rules for applying section 6015(b)(1)(D), the fourth requirement for innocent spouse relief. Taking into account all facts and circumstances, it must be inequitable to hold the requesting spouse liable for the deficiency. Section 1.6015-2(d) of the proposed regulations is problematic in two respects.

Section 1.6015-2(d) of the proposed regulations states that one relevant factor in the determination under section 6015(b)(1)(D) is whether the requesting spouse significantly benefited from the understatement. It goes on to say that “if a requesting spouse receives property ... from the nonrequesting spouse that is
traceable to items omitted from gross income that are attributable to the nonrequesting spouse, the requesting spouse will be considered to have received significant benefit from those items”. It also says that the fact that the parties were not members of the same household for the twelve months preceding the election would be a factor relevant to the determination of whether the spouse received a significant benefit.

It is inappropriate to conclude that a requesting spouse receiving items from the nonrequesting spouse in a divorce has received a “significant benefit” from such items without considering the property settlement as a whole. Certainly, that would be a factor to consider, particularly where the requesting spouse’s share of the marital (or community) estate overall is increased by reason of the inclusion of the erroneous item in the property to be divided. But equitable distribution is not always equitable. Assets received by the requesting spouse in a divorce settlement include funds constituting unreported income but that spouse’s share of the marital property may be far less than her equitable share of the marital estate, particularly where she is the dominated spouse and has little or no money to pursue her equitable distribution claims in court.

It is also inappropriate to regard the duration of a couple’s separation, twelve months or otherwise, as relevant to the determination under section 6015(b)(1)(D). Parties may settle two months or two years after the date of separation; the equities of the settlement do not turn on the length of separation.

The Secretary may wish to consider substituting the phrase “will be presumed” for the phrase “will be considered” in the sentence quoted above (the fifth sentence of the proposed regulation). The proposed regulation would thus fall short of expressing a per se rule. In addition, the Secretary may wish to revise and simplify the second to last sentence of section 1.6015-2(d), by substituting the following text: “The presumption may be rebutted, however. For example, the requesting spouse may overcome the presumption by showing that the spouses are separated or divorced and that their property division at divorce was disproportionately in favor of the nonrequesting spouse or that the nonrequesting spouse has not fulfilled his or her support obligations to the requesting spouse”.

Prop. Reg. § 1.6015-3(b)(2).

Sections 1.6015-3(b)(1) and (2) of the proposed regulations define “divorced” and “legally separated” for purposes of section 6015(c) without discussing or even mentioning the rules for determination of marital status under section 7703. The Secretary may wish to consider whether cross referencing the regulations under 7703 would be advisable. While it is true that the Service and some circuit courts of appeal have differed on what constitutes a valid divorce under section 7703, a taxpayer in a particular jurisdiction should be considered divorced (or not) for all tax purposes.


Section 1.6015-3(b)(3) of the proposed regulations interprets “not members of the same household” for purposes of section 6015(c)(3)(A)(i)(II), but it fails to mention one increasingly common situation. There are a number of spouses who live in separate households indefinitely for business or other reasons, but
these taxpayers do not intend to be separated in the common sense of the word. They are not estranged. Do these taxpayers fall within the scope of section 1.6015-3(b)(3)(ii)? As a policy matter, these couples should not get the benefit of section 6015(c). In any case, the proposed regulations should clarify where they fit in.

5.

Prop. Reg. § 1.6015-3(c)(2)(iii).
Prop. Reg. § 1.6015-3(c)(4).

Section 6015(c)(3)(C) provides that a requesting spouse will not be eligible for relief under section 6015(c) with respect to any erroneous item to the extent he or she had actual knowledge of the item at the time he or she signed the return. Section 1.6015-3(c)(2) of the proposed regulations sets forth rules relating to actual knowledge within the meaning of 6015(c)(3)(C). Two rules, which are fairly straightforward, merit two comments.

The first and second sentences of the second paragraph of section 1.6015-3(c)(2)(iii) of the proposed regulations provide: “One factor that may be relied upon in demonstrating that a requesting spouse had actual knowledge of an erroneous item is whether the spouse made a deliberate effort to avoid learning of the item in order to be shielded from liability. This factor, together with all other facts and circumstances, may demonstrate that the spouse had actual knowledge of the item.” These sentences, read together, verge on expressing an improper constructive knowledge standard. The rules and examples under the proposed regulations do not otherwise appear to adopt this incorrect standard. To eliminate any question in this regard, the Secretary may wish to add an example which illustrates the scope of the first two sentences of section 1.6015-3(c)(2)(iii).

Section 1.6015-3(c)(2)(iii) of the proposed regulations states that joint ownership of property resulting in an erroneous item will be a factor that may be relied on in demonstrating that a requesting spouse had actual knowledge of the item. However, many spouses who are co-owners of an income producing asset do not even know they own the asset, much less that it has produced income, particularly in community property states. Thus, the Secretary may wish to consider substituting the phrase “one factor that can be relied on in demonstrating” with the phrase “one factor that is relevant in determining”.

6.

Prop. Reg. § 1.6015-3(c)(4).

The proposed regulations under section 6015(c)(4)(B) are troublesome in several respects.

Section 6015(c)(4)(B)(ii)(II), a statutory exception to the disqualified asset presumption, uses the phrase “decree of divorce or separate maintenance or a written instrument incident to such a decree”. This language is lifted from section 71(b)(2)(A), the first example of a qualified divorce and separation instrument under section 71(b)(1)(A), dealing with alimony. The definition of an instrument constituting a decree of divorce or separate maintenance or a written instrument incident to such a decree under section 71(b)(1)(A) is fairly well established. However, section 1.6015-3(c)(3)(iii) of the proposed regulations substitutes “divorce decree or separate maintenance agreement” for the terms used in the statute. Suffice to say, the statutory and regulatory terms are not synonymous. Further, “separate maintenance agreement”
is an inappropriate use of terms in any case. Such things exist in a domestic relations practice but they are not divorce decrees and in many cases they would not constitute an instrument incident to a decree within accepted meaning of section 71(b)(2)(A).

For the above reasons, the Secretary may wish to consider substituting “decree of divorce or separate maintenance or a written instrument incident to such a decree” for “divorce decree or separate maintenance agreement” in section 1.6015-3(c)(3)(iii) of the proposed regulations. The Secretary may also wish to add at the end of the paragraph: “These instruments are the same as divorce and separation instruments under section 71(b)(2)(A). See section 1.71-1T(a), Q&A-4, of the temporary regulations.”

Example 6 of section 1.6015-3(c)(4) of the proposed regulations provides two examples in which the taxpayer failed to overcome the disqualified asset presumption. It would be helpful to include an example where the requesting spouse overcomes the presumption.

The transfer in Example 7 of section 1.6015-3(c)(4) of the proposed regulations is made pursuant to a divorce decree, one statutory exception to the disqualified asset presumption. The Secretary may want to address the potential for abuse here. Divorce decrees may be adjudicated, but they may also be consent orders incorporating the parties’ property settlement agreement. (An instrument incident to a decree may be a settlement agreement as well). Will the transfer fall under the divorce decree exception if the source of the obligation is the parties’ agreement? See Harris v. Commissioner, 340 U.S. 106 (1950) and Rev. Rul. 60-160, 1960-1 C.B. 374.

7.


Section 6015 refers to both fraud and fraudulent schemes. The Secretary may want to consider adding an example illustrating the difference between a fraudulent scheme (relief not available under section 6015) and fraud (Secretary may allocate any item appropriately between spouses if allocation is inappropriate due to fraud...)

8.

Prop. Reg. § 1.6015-3(d)(3).

Section 6015(c)(2) places the burden of proof on the requesting spouse to establish the portion of the deficiency allocable to him or her. A real problem arises, however, where the nonrequesting spouse has the tax files, Internal Revenue Service correspondence, notice of deficiency, etc. and will not turn over the documents to the requesting spouse. (For instance, divorce counsel for the requesting spouse may receive the following response to a discovery request directed at the other spouse: “I don’t have them; they are lost”). Practically speaking, it is impossible for a requesting spouse to meet his or her burden of proof if he or she does not even know what items have given rise to the deficiency. At some point, the Internal Revenue Service may turn over documents from its files but not necessarily before the requesting spouse needs to file his or her Form 8857 in order to freeze collection efforts. (c.f. section 1.6015-1(a)(2) of the proposed regulations stating that the Secretary may not grant relief under section 6015(b) or (c) if the spouse seeks relief only under (f)). The regulations under section 6015(c)(2) should address the requesting spouse’s recourse in this situation.