

FAMILY LAW NEWS

JUNE • TWO THOUSAND AND THREE

INSIDE...

1
HELPING PARENTS SERVE THE
BEST INTERESTS OF CHILDREN
Hon. David R. Ostapuk

4
PARENTS' ACKNOWLEDGMENT

6
A VIEW FROM THE BENCH
Judge Nanette M. Warner

7
NOTICE TO ATTORNEYS

8
ADMINISTRATIVE REVIEW
AT DCSE
Janet W. Sell, Esq.

9
ELECTION OF 2003-2004
EXECUTIVE COUNCIL OFFICERS
AND MEMBERS-AT-LARGE

10
FROM THE CHAIR
Bernadette A. Ruiz, Esq.

11
ARIZONA CASE LAW UPDATE
Judge Mark W. Armstrong

11, 16
BAR CONVENTION

12
ADDITIONAL DISSOLUTION
CONSIDERATIONS
Susannah Sabnekar,
CPA/ABV

14
WHY INNOCENT SPOUSE RELIEF
SHOULD BE CONSIDERED IN
DIVORCE
Jason M. Silver, Esq.

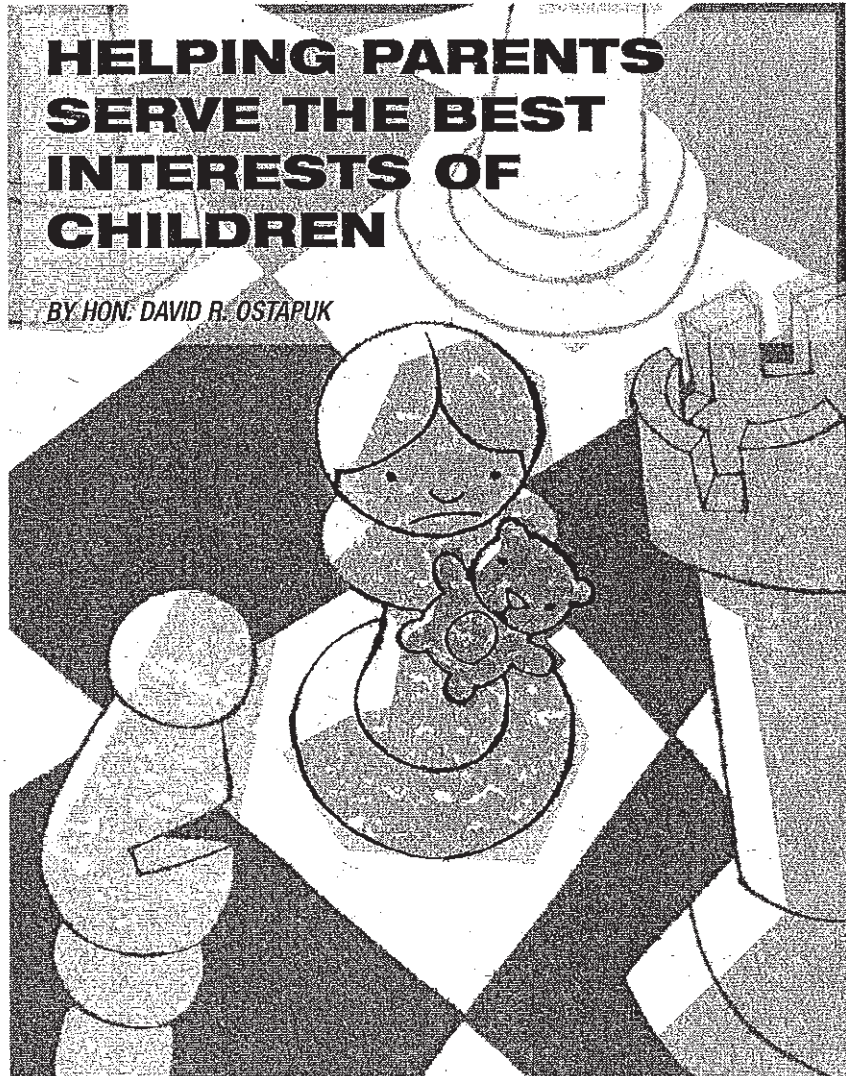
70 YEARS OF SERVICE
1933-2003

STATE BAR
of ARIZONA

Published by the
Family Law
Section of
The State Bar of
Arizona

HELPING PARENTS SERVE THE BEST INTERESTS OF CHILDREN

BY HON. DAVID R. OSTAPUK



Family Law attorneys know that decisions regarding children are made according to the best interests of the children, taking into account many factors. As counsel involved with families also know full well, when the family unit, however it is constructed, breaks and is no longer functional, parents sometimes fail to see clearly what is in the best interest of the children.

Attorneys perform a very important role in guiding parents through the legal process. They have a great opportunity to help parents understand that what

they do and say during and after the period of separation or divorce will affect their children far more than the divorce or separation itself. Counsel have an important and large influence on how a families' litigation progresses through the courts, and on how the parties handle the awesome responsibility of deciding, or helping the court to decide what is in the best interests of their children.

To be sure, there are other resources available to parents at such times. Mandatory Parent Education about the effects of divorce or separation on children

Why Innocent Spouse Relief Should Be Considered In Divorce

By Jason M. Silver, Esq.

A new divorce client informs you at your first meeting that her role in the family was to raise the children and that recently, her husband informed her that the Internal Revenue Service (the "Service") made an assessment of several hundreds of thousands of dollars for omissions of income from the married filing joint income tax returns. Since your client filed a joint return, there is joint and several liability for the tax liability reported on the income tax return. Your client is jointly and severally liable for the entire tax liability even though she had no involvement with the income generating activity. Code § 60151 of the Internal Revenue Code (the "Code") may allow your client to escape the tax liability as an Innocent Spouse.

Under the new Code § 6015¹, there are now three different paths the client can take advantage of under innocent spouse relief. The different paths are:

- Innocent Spouse Relief Relating to all Joint Filers - Traditional Innocent Spouse Relief;
- Innocent Spouse Relief for Taxpayers No Longer Married or Separated - The Separate Liability Election; and
- Innocent Spouse Relief for Those Otherwise Deserving - Equitable Innocent Spouse Relief.

For those taxpayers who are not separated, divorced or living apart for twelve months, Traditional Innocent Spouse relief is available. Under the Traditional Innocent Spouse Relief, the spouse must show that (1) A joint return was filed for the taxable year; (2) there is an understatement of tax attributable to erroneous items of one of the individuals filing the return; (3) the other individual filing the joint return establishes that in signing the return, he or she did not know, and had no reason to know, that there was such an understatement of tax; (4) taking into account all the facts and circumstances, it would be inequitable to hold the other individual liable for the deficiency attributable to such understatement;² and (5) the individual elects innocent spouse not later than the date which is two years after the date the Service has begun collection activities with respect to the individual making the election.

In *Wiksell v. Commissioner*³ The Ninth Circuit allowed apportionment of innocent spouse relief, which led Congress to change Traditional Innocent Spouse Relief to allow the other spouse to be partially innocent. Now, if the individual knew or had reason to know of an item, but did not know or have reason to know the extent of such understatement, the individual is relieved of liability to the

extent that they did not know or have reason to know of the understatement.⁴

A major change to the innocent spouse provisions are the new procedures limiting liability for the spouse who is no longer married, who is legally separated, or who is not living with the spouse. The so-called Separate Liability Election allows the spouse who previously filed a joint income tax return to make an election limiting that individual's liability for any tax deficiency to the amount of deficiency which would be allocated to the innocent spouse if the spouse had filed a separate return.⁵ Because Arizona is a community property state, assuming no agreement stating otherwise, all income must be split between the husband and wife equally. For purposes of allocating income as if married filing separate returns, community property laws are ignored.⁶ This is particularly important for the spouse who had no involvement in the income-producing activity. Remember, this path is only for divorced, legally separated, and individuals who were not members of the same household as the individual with whom such joint return was filed at any time during the twelve month period ending on the date the Separate Liability Election is filed.⁷

A Separate Liability Election must be made no later than two years after the date the Service has begun collection activities with respect to the individual making the election.⁸

The Separate Liability Election is not available if the spouse had "actual knowledge" of the item giving rise to the deficiency at the time such individual signed the joint tax return, unless that spouse can demonstrate the tax return was signed under duress.⁹ The Service has the burden of proving there was actual knowledge giving rise to the tax deficiency existed.¹⁰

In order to prevent spouses from transferring assets, any separate liability is increased by the value of any disqualified asset transferred to the individual.¹¹ A disqualified asset is any property or right to property transferred to an individual if the principal purpose of the transfer was the avoidance of tax or the avoidance of payment of tax.¹² Any asset transferred within a year before the issuance of a proposed deficiency is rebuttably presumed to have as its principal purpose the avoidance of tax or the avoidance of payment of tax.¹³ The presumption does not apply to any transfer pursuant to a divorce decree or separate maintenance or written instrument incident to such decree or to any transfer which an individual establishes did not have as its principal purpose the avoidance of tax.¹⁴ Additionally, if the Service proves that assets were transferred between the spouses as part of a "fraudulent scheme" to avoid col-

lection of the tax liability, the Separate Liability Election is wholly invalid.¹⁵

The third and final way to get relief under I.R.C. § 6015, if neither of the first two paths are available, is Equitable Innocent Spouse Relief.¹⁶ If relief is not available under the two previous paths—Traditional Innocent Spouse Relief or the Separate Liability Election—the Service is given discretion to relieve the spouse of liability, if taking into account all facts and circumstances, it would be inequitable to hold the individual liable for any unpaid tax.¹⁷ This provision provides that the Secretary may relieve such individual of such liability. Unfortunately, the United States Tax Court does not have jurisdiction to review a denial under equitable relief.¹⁸

In addition to not being able to take advantage of the first two paths, there cannot be a transfer of assets as part of a fraudulent scheme and if there is a transfer of disqualified assets, any relief will be available only to the extent the liability exceeds the value of such disqualified assets.

The Service will ordinarily grant equitable relief where there is a liability reported on the joint return unpaid at the time the return was filed, the person seeking relief was not married to, was legally separated from or was living apart from the spouse with whom the joint return was filed, and the person seeking relief did not know and had no reason to know that the tax would not be paid.¹⁹ The individual must establish that it was reasonable to believe that the non-requesting spouse would pay the reported liability. Also, the innocent spouse must demonstrate that he or she will suffer undue hardship if relief from the liability is not granted. Undue hardship is defined under I.R.S. Treasury Regulation § 1.6161-1(b). Finally, there is an overriding exception preventing relief under the ordinarily will be granted category, if the unpaid liability is attributable to the requesting spouse. This means that if the unpaid tax liability is attributable to earnings of the requesting spouse, relief will not be granted.

The second and broader category of Equitable Innocent Spouse Relief exists when it would be inequitable to hold the individual liable taking into account all the facts and circumstances. The Service has not set forth the circumstances under which relief would ordinarily be granted for this broader category of cases, but has set forth a number of factors which would weigh in favor of and against relief.²⁰ Factors weighing in favor of relief include: the individual requesting relief is separated or divorced; the individual would suffer hardship if relief was not granted, even if the hardship does not constitute undue hardship; the individual was abused by his or her spouse, even though such abuse did not amount to duress; and whether the non-requesting spouse has a legal obligation pursuant to a divorce decree or agreement to pay the liability. Factors weighing against relief include: the unpaid liability is attributable to the individual requesting relief; the individual requesting relief significantly benefitted (beyond normal support) from the unpaid liability or items given rise to the

deficiency; the individual requesting relief had a legal obligation pursuant to a divorce decree or agreement to pay the liability; and the individual had knowledge or reason to know of the unpaid liability or deficiency.²¹

In the case of both Traditional Innocent Spouse Relief and the Separate Liability Election, the individual must seek to elect relief no later than the date which is two years after the date the Service has begun collection activities with respect to the individual making the election.²² Relief under any of the provisions is requested by filing a Form 8857, Request for Innocent Spouse Relief.

The new law applies not only to a tax arising after the date of the enactment, but to "any liability for tax arising on or before the date of [enactment] remaining unpaid as of such date."²³ A taxpayer is allowed to petition the United States Tax Court within ninety days after the Service mails a certified or registered mail notice denying (in whole or in part) innocent spouse relief to the individual.²⁴ If the Service does not respond to a request for innocent spouse within six months following the election, a United States Tax Court petition can be filed.²⁵

With the expansion of innocent spouse relief comes many new avenues to explore in extricating an innocent spouse from tax liabilities attributable to the income generating spouse. But, be cautious of the many pitfalls.

Jason M. Silver is a member of Walker Silver, PLC, located in Scottsdale, Arizona. He specializes in civil and criminal tax litigation.

ENDNOTES

1. Pub. Law. 105-206
2. I.R.C. § 6015(b).
3. 90 F.3d 1459 (9th Cir. 1997).
4. I.R.C. § 6015(b)(2).
5. I.R.C. § 6015(c)(1) and § 6015(d)(3)(A).
6. I.R.C. § 6015(a) (flush language); H.R. Conf. Rep. No. 105-599, 105th Cong., 2d Sess. (1998).
7. I.R.C. § 6015(c)(3)(A).
8. I.R.C. § 6015(c)(3)(B).
9. I.R.C. § 6015(c)(3)(C).
10. I.R.C. § 6015(c)(2).
11. I.R.C. § 6015(c)(4)(A).
12. I.R.C. § 6015(c)(4)(B)(i).
13. I.R.C. § 6015(c)(4)(B)(ii)(I).
14. I.R.C. § 6015(c)(4)(B)(ii)(II).
15. I.R.C. § 6015(c)(3)(A)(ii).
16. I.R.C. § 6015(f).
17. I.R.C. § 6015(f).
18. See I.R.C. § 6015(e)(1).
19. IRS Notice 98-61, I.R.B. 1998-51 (Dec. 21, 1998).
20. *Id.*
21. *Id.*
22. I.R.C. § 6015(b)(1)(E) (Traditional Innocent Spouse Relief); I.R.C. § 6015(c)(3)(B) (Separate Liability Election).
23. Act Section 3201(g)(1).
24. I.R.C. § 6015(e).
25. *Id.*