

Allow Taxpayers to Request Equitable Relief Under Internal Revenue Code Section 6015(f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions

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## Allow Taxpayers to Request Equitable Relief Under Internal Revenue Code Section 6015(f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions

### PROBLEMS

Married taxpayers who file joint returns are jointly and severally liable for any deficiency or tax due.<sup>1</sup> Spouses who live in community property states and file separate returns are generally required to report half of the community income on their separate returns.<sup>2</sup> Internal Revenue Code (IRC) §§ 6015 and 66, sometimes referred to as the “innocent spouse” rules, provide relief from joint and several liability and from the operation of community property rules. In addition to providing for relief in specific circumstances as described in subsections 6015(b), 6015(c), and 66(c), each statute grants the IRS the authority to establish procedures for relieving a spouse of liability when, in consideration of all the facts and circumstances, it would be inequitable to hold the spouse liable. These latter provisions are known as “equitable relief.” Neither IRC § 6015 nor IRC § 66 requires taxpayers to request equitable relief within a specified time. However, a Treasury regulation provides that a taxpayer must request equitable relief from liability arising from a joint return under IRC § 6015(f) within two years after the IRS initiates collection activity with respect to the taxpayer.<sup>3</sup> Additional IRS guidance imposes the same deadline for claims for equitable relief from the operation of community property rules under IRC § 66.<sup>4</sup> Taxpayers who seek relief after the two-year period are harmed because relief is foreclosed in situations for which IRC § 6015(f) was intended to provide a “safety valve,” *e.g.*, where the delay was due to deceit or intimidation by a joint filer.<sup>5</sup> The U.S. Tax Court recently held the regulation invalid, and although the decision was reversed by the U.S. Court of Appeals for the Seventh Circuit,<sup>6</sup> the Tax Court adheres to its position in cases appealable to other Courts of Appeals.<sup>7</sup> The IRS maintains that the regulation is a valid interpretation of IRC § 6015(f) and has appealed the issue to other Courts of Appeal.<sup>8</sup> As discussed in detail in Volume

<sup>1</sup> Internal Revenue Code (IRC) § 6013(d)(3); Rev. Proc. 2003-61, 2003-2 C.B. 296.

<sup>2</sup> *Poe v. Seaborn*, 282 U.S. 101 (1930).

<sup>3</sup> Treas. Reg. § 1.6015-5(b)(1).

<sup>4</sup> Rev. Proc. 2000-15, §§ 4.01(3) and 5, 2000-1 C.B. at 448, 449, *superseded by* Rev. Proc. 2003-61, §§ 4.01(3) and 5, 2003-2 C.B. at 297, 299.

<sup>5</sup> As the Tax Court noted in *Hall v. Comm’r*, 135 T.C. No. 19, slip op. at 12 (Sept. 22, 2010), “application of the 2-year limits in subsections (b) and (c) makes subsection (f) ineffective in situations where an innocent spouse is unaware of the need to or unable to contact the IRS for some of the very reasons that Congress considered in enacting section 6015. For example, a spouse is sometimes subject to abuse by a partner. The abuse can take many forms. Where a spouse is prevented from acting by fear, intimidation, or fraud, an administrative procedural hurdle would eliminate consideration of relief by the IRS. The Secretary did not allow any exception even for extreme cases, but rather adopted a strict time bar that requires the IRS to deny relief without any consideration of the facts and circumstances.”

<sup>6</sup> *Lantz v. Comm’r*, 132 T.C. 131 (2009), *reversed and remanded by* 607 F.3d 479 (7th Cir. 2010).

<sup>7</sup> See *Hall v. Comm’r*, 135 T.C. No. 19 (Sept. 22, 2010).

<sup>8</sup> *E.g.*, *Mannella v. Comm’r*, 132 T.C. 196 (2009), *appeal docketed*, No. 07-175310 (3rd Cir. Jan. 25, 2010); *Coulter v. Comm’r*, Tax Court Docket No. 1003-09, *appeal docketed*, No. 10-680 (2d Cir. Feb. 24, 2010); *Buckner v. Comm’r*, Tax Court Docket No. 12153-09, *appeal docketed*, No. 10-2056 (6th Cir. Aug. 18, 2010); *Jones v. Comm’r*, Tax Court Docket No. 17359-08, *appeal docketed*, No. 10-1985 (4th Cir. Aug. 30, 2010).

2 of this report, the National Taxpayer Advocate believes that the language and legislative and administrative history of IRC § 6015 and its predecessor IRC § 6013(e) make clear that Congress did not intend to limit claims for equitable relief to a two-year window.<sup>9</sup> While the courts will ultimately settle this question, in the meantime, taxpayers are harmed by both the IRS's continued enforcement of the two-year rule and the uncertainty in the law. Therefore, the National Taxpayer Advocate recommends that Congress explicitly state that a taxpayer may raise a claim for relief under IRC § 6015(f) and § 66(c) at any time before the statutory period for collecting the tax expires.

### EXAMPLE 1

In *Lantz v. Commissioner*,<sup>10</sup> Mrs. Lantz's spouse, Dr. Chentnik, had income from Medicare fraud that he did not report when he prepared the couple's 1999 joint return. Mrs. Lantz was unaware of the fraud and relied on her husband to resolve the tax issue that arose when it was discovered. In his correspondence with the IRS, Dr. Chentnik, who was incarcerated at the time, characterized Mrs. Lantz as an innocent spouse and asked that the IRS send him the appropriate forms so he could claim innocent spouse relief on behalf of Mrs. Lantz. Dr. Chentnik died in a halfway house without requesting relief on Mrs. Lantz's behalf or informing her that he had not requested innocent spouse relief. When Mrs. Lantz requested equitable relief under IRC § 6015(f), the IRS denied her claim because she had not requested relief within two years of the first collection activity. The IRS concedes that Mrs. Lantz would be entitled to relief under IRC § 6015(f) if her claim had been timely filed.

In addition to the problem of the two-year rule, the National Taxpayer Advocate has identified a disturbing trend of restricting a taxpayer's ability to raise IRC § 6015 as a defense in collection suits in district court.<sup>11</sup> This development continues to harm taxpayers.<sup>12</sup>

### EXAMPLE 2

A taxpayer ("W"), whose English proficiency was extremely limited, filed jointly with her husband ("H") in 1985 and 1986.<sup>13</sup> Unbeknownst to W, H had income from his sole proprietorship, which he used to support his mistress. The IRS discovered the income and assessed a total of \$35,000 in taxes and penalties for the two years. H hid from W all notices pertaining to the tax assessment and collection efforts. Years later, after H abandoned his wife and family and fled the country, the United States reduced the liens to judgment.

<sup>9</sup> For a more detailed discussion of this topic and recommendation, see *Unlimit Innocent Spouse Equitable Relief*, vol. 2, *infra*.

<sup>10</sup> 132 T.C. 131 (2009), *reversed and remanded by* 607 F.3d 479 (7th Cir. 2010).

<sup>11</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 631; National Taxpayer Advocate 2008 Annual Report to Congress 524; National Taxpayer Advocate 2009 Annual Report to Congress 487.

<sup>12</sup> See Most Litigated Issue, *Relief from Joint and Several Liability Under Internal Revenue Code Section 6015*, *infra*.

<sup>13</sup> This example is generally based on a case in which the National Taxpayer Advocate, when she was Executive Director of the Community Tax Law Project in Richmond, Virginia, served as the taxpayer's representative.

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W learned about the tax liability when the IRS offset her Earned Income Tax Credit refund and about the judgment when she attempted to refinance her home. When W sought innocent spouse relief, more than two years had elapsed since the IRS's first collection activity. In 1997, almost ten years after the IRS assessed the tax and initiated collection activity, the IRS abated the tax against W and refunded all amounts collected from her as permitted under IRC § 6511(b)(2)(B).<sup>14</sup> Under these facts today, W would be ineligible for innocent spouse relief under IRC § 6015(b) or (c) because she did not submit her claim within the *statutory* two-year period, and would be barred from IRC § 6015(f) relief by the *regulation's* two-year limit.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that Congress amend IRC §§ 6015 and 66 to specify that:

1. Effective with respect to any liability for tax arising after the date of enactment and any liability for tax arising on or before such date but remaining unpaid as of such date, taxpayers may request equitable relief at any time before expiration of the period of limitations on collection,<sup>15</sup> regardless of whether the taxpayer previously received a final administrative determination denying as untimely a request for equitable relief for the same tax year or meaningfully participated in a prior proceeding in which equitable relief for the same tax year was denied as untimely; and
2. Taxpayers may raise innocent spouse relief as a defense in a proceeding brought under any provision of title 26 (including §§ 6213, 6320, 6330, 7402, and 7403) or any case under title 11 of the United States Code.

## CURRENT LAW

IRC § 6015(f) and the flush language of IRC § 66(c), in identical terms, provide for equitable relief where “taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or any deficiency (or any portion of either).” IRC § 6015 (e)(1)(A) provides that an individual who seeks relief from joint liability may, “in addition to any other remedy provided by law” petition the Tax Court to determine the

<sup>14</sup> If a claim for credit or refund is filed within two years of a payment on the underlying tax liability (but not within three years of a return filing), IRC § 6511(b)(2)(B) limits the credit or refund to amounts paid during the two years immediately preceding the claim.

<sup>15</sup> See IRC § 6502.

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appropriate relief available. Other statutory provisions and judicial precedent make clear that taxpayers may raise IRC § 6015 relief in a variety of contexts.<sup>16</sup>

## REASONS FOR CHANGE

As discussed in greater detail in Volume 2 of this report, innocent spouse relief was first enacted in 1971 and was revised in 1984, but prior to 1998 the innocent spouse provisions did not contain a statute of limitations.<sup>17</sup> From 1971 until 1998, nothing impeded the IRS from considering claims for relief under IRC § 6013(e) at any time before expiration of the statutory period of limitations on collection, generally ten years after the date the tax is assessed.<sup>18</sup> The innocent spouse provisions were revised as part of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98)<sup>19</sup> because, according to the Senate Committee on Finance, “the innocent spouse provisions of present law are inadequate.”<sup>20</sup> While statutory limitation periods were explicitly stated for relief under IRC § 6015 (b) and (c), RRA 98 was silent as to the time limit within which taxpayers must request equitable relief, thereby implicitly retaining for IRC § 6015(f) relief the general statute of limitation period for collection actions.<sup>21</sup>

Equitable relief under IRC §6015(f) is “a safety-valve provision for innocent spouses who fall through cracks in (b) or (c).”<sup>22</sup> In hearings that preceded enactment of RRA 98, witnesses who were ineligible for relief under IRC § 6013(e) described to the Senate Committee on Finance how (1) they had not learned of the underlying assessment because their spouses hid IRS notices or (2) they were unaware that the tax had not been paid because their

<sup>16</sup> See IRC §§ 6320(c) and 6330(c)(2)(A)(i) (pertaining to collection due process proceedings); IRC § 6213 and *Corson v. Comm’r*, 114 T.C. 354, 363 (2000) (pertaining to deficiency proceedings); 11 U.S.C. § 505(a) (pertaining to bankruptcy proceedings); and IRC § 7422 (pertaining to refund suits). See also *Pollock v. Comm’r*, 132 T.C. 21 (2009). In *Pollock*, the United States filed a collection suit seeking to foreclose its lien on the residence of the putative innocent spouse. The district court stayed the proceedings to permit the taxpayer to file a petition for relief in the Tax Court. In holding that the doctrine of equitable tolling did not apply to the 90-day period for filing a Tax Court petition, the court noted that “Perhaps not all hope is lost – the Commissioner conceded at oral argument that if [the taxpayer] filed a refund action in District Court after her home was seized and sold, [the taxpayer] could try to make her case that she is an innocent spouse.” 132 T.C. at 37 n. 21. The Tax Court had earlier held in *Thurner v. Comm’r* that *res judicata* barred the taxpayer from raising IRC § 6015 as a defense in the Tax Court proceeding because the taxpayer could have raised IRC § 6015 as a defense in a prior collection suit. 121 T.C. 43 (2003).

<sup>17</sup> See Pub. L. No. 91-679 (adding IRC § 6013(e)); Pub. L. No. 98-369, sec. § 424, 98 Stat. 801 (1984) (expanding the class of understatements for which innocent spouse relief was available).

<sup>18</sup> IRC § 6502(a). However, if a court proceeding to collect the tax is brought, such as a suit to reduce a tax liability to judgment, the period of limitations on collection is extended. Therefore, the period of limitations on collection could exceed ten years and a claim for innocent spouse relief would be valid at any point during that time.

<sup>19</sup> Pub. L. No. 105-206, sec. 3201(a), (b), 112 Stat. 685 at 734, 739.

<sup>20</sup> S. Rep. 105-174, accompanying H.R. 2676 (enacted as RRA 98), 105th Cong., 2nd Sess. (1998) at 55.

<sup>21</sup> See *General Motors Corp. v. U.S.*, 496 U.S. 530, 538 (1990); *Russello v. U.S.*, 464 U.S. 16, 23 (1983) (stating “where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion”).

<sup>22</sup> *Lantz v. Comm’r*, 607 F.3d 479 at 484 (7th Cir.2010). As the conference report accompanying H.R. 2676 (enacted as RRA 98) stated, “The conferees do not intend to limit the use of the Secretary’s authority to provide equitable relief to situations where tax is shown on a return but not paid. The conferees intend that such authority be used where, taking into account all the facts and circumstances, it is inequitable to hold an individual liable for all or part of any unpaid tax or deficiency arising from a joint return. The conferees intend that relief be available where there is both an understatement and an underpayment of tax.” H.R. Conf. Rep. No. 105-599, 105th Cong., 2nd Sess. 254-255 (1998).

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spouses had assured them it had been taken care of. Several of the witnesses learned about the tax debt many years after assessment and the initiation of collection activity.<sup>23</sup>

The IRS, by subjecting § 6015(f) claims to the same new limitations period as claims under (b) and (c), tightens the safety valve Congress provided. Moreover, the equitable relief provisions were part of a statutory scheme intended to address the perceived inadequacy of prior law; delay in claiming equitable relief may arise because of the very circumstances for which Congress intended to provide relief.<sup>24</sup> If not for the IRS's interpretation of the time limits for claiming equitable relief, which the Tax Court held was invalid, changes to the statutes would be unnecessary. However, because taxpayers are being harmed while this issue is litigated in the courts, the National Taxpayer Advocate recommends that Congress act to reaffirm the availability of the safety valve without the time limit imposed by the regulation.<sup>25</sup>

Although statutory provisions and judicial precedent make clear that taxpayers may raise IRC § 6015 in a variety of contexts,<sup>26</sup> taxpayers are harmed when district courts refuse to consider their innocent spouse claims as a defense in collection suits.<sup>27</sup> The National Taxpayer Advocate first identified this disturbing trend in 2007, and the Taxpayer Advocate Service continues to see this issue from time to time.<sup>28</sup> Therefore, Congress should clarify that the defense can be raised in all proceedings brought under any provisions of title 26 of the United States Code, including an action under IRC § 7402 to reduce federal tax assessments to judgment and a suit under IRC § 7403 to foreclose a tax lien on real property, or any case under title 11.

## EXPLANATION OF RECOMMENDATION

The first recommendation would specify that taxpayers may request equitable relief without regard to the time that elapses between the commencement of collection activity and the request for relief. As long as the period of limitations for collection of the liability remains open, taxpayers may request innocent spouse relief with respect to deficiencies

<sup>23</sup> Sen. Comm. on Finance, *IRS Restructuring Hearings*, 105th Cong., 2nd Sess. (Jan. 28-29; Feb. 5, 11 & 25, 1998).

<sup>24</sup> See *Unlimit Innocent Spouse Equitable Relief*, vol. 2, *infra*, for a discussion of the similarity between innocent spouse cases described in 1998 congressional testimony and recent cases in which relief was denied because the claim was untimely.

<sup>25</sup> The National Taxpayer Advocate previously recommended making it explicit that a taxpayer may request equitable relief from liabilities under IRC § 6015(f) or IRC § 66(c) at any time the IRS could collect such liabilities (*i.e.*, any time before expiration of the statute of limitations on collection). National Taxpayer Advocate 2006 Annual Report to Congress 540 (Legislative Recommendation: *Eliminate the Two-Year Limitation Period for Taxpayers Seeking Equitable Relief Under IRC § 6015 or § 66*).

<sup>26</sup> See note 16, *supra*.

<sup>27</sup> See, *e.g.*, *U.S. v. Wallace*, 105 A.F.T.R.2d 2827 (S.D. Ohio Apr. 28, 2010), *adopted by* 105 A.F.T.R.2d (RIA) 2831 (S.D. Ohio June 8, 2010); *U.S. v. Pollock*, No. 06-80903 (S.D. Fla. filed Sept. 27, 2006); *U.S. v. Boynton*, 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007); *U.S. v. Bucy*, 100 A.F.T.R.2d (RIA) 6666 (S.D. W. Va. 2007); *U.S. v. Cawog*, 97 A.F.T.R.2d (RIA) 3069 (W.D. Pa. 2006), *appeal dismissed* (3d Cir. 2007); *U.S. v. Feda*, 97 A.F.T.R.2d (RIA) 1985 (N.D. Ill. 2006).

<sup>28</sup> The National Taxpayer Advocate twice recommended that legislation clarify that taxpayers may raise relief under IRC §§ 6015 and 66 as a defense in collection actions. National Taxpayer Advocate 2007 Annual Report to Congress 549; National Taxpayer Advocate 2009 Annual Report to Congress 378. For a discussion of *U.S. v. Wallace*, a case in which the issue arose this year, see Most Litigated Issue: *Relief from Joint and Several Liability Under Internal Revenue Code Section 6015*, *supra*.

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and underpayments. The provision should be effective with respect to any liability for tax arising after the date of enactment and any liability for tax arising on or before such date but remaining unpaid as of such date.<sup>29</sup> Additionally, allowing taxpayers whose requests for equitable relief were previously denied as untimely to obtain relief, in light of removal of the two-year period, would require careful drafting of the effective date in order to extend relief to taxpayers who were previously denied equitable relief solely because the claim was made more than two years after collection activity commenced, as long as the period of limitations on collection has not expired. In the case of credits or refunds, taxpayers would still be subject to the general requirements and time limitations found in IRC § 6511. This recommendation would be consistent with Congress' intent in enacting the innocent spouse rules, would correct the IRS's misinterpretation of the statutes, and would avert a potential conflict among the Courts of Appeals. The second recommendation would clarify that, consistent with the statutory language of IRC § 6015 and other statutory and judicial provisions, taxpayers may raise IRC § 6015 as a defense in district court collection suits. This recommendation would avert further confusion as to whether the defense is allowed in district court collection suits, and would provide uniformity among district courts.

<sup>29</sup> The effective date of IRC § 6015 as originally enacted was identical, applying to "any liability for tax arising after the date of the enactment of this Act and any liability for tax arising on or before such date but remaining unpaid as of such date." Pub. L. No. 105-206, sec. 3201(g)(1), 112 Stat. 685 at 740. Moreover, when IRC § 6015 was amended in 2006 to clarify that the Tax Court has jurisdiction to review "stand alone" cases under IRC § 6015(f) (*i.e.*, petitions filed in response to a notice of determination, or after the claim has been pending for more than six months, where no deficiency has been asserted), the effective date of the amendment was similar, applying "with respect to liability for taxes arising or remaining unpaid on or after the date of the enactment of this Act." Pub. L. No. 109-432, sec. 408(c), 120 Stat. 2922, 3062.