Can You Prove That You're Innocent? IRS Relaxes "Innocent Spouse" Rules

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A new IRS Notice provides some more leeway for taxpayers seeking relief under the "innocent spouse" rules. This change of heart continues a recent trend.

Although filing a joint tax return may provide other tax benefits, each spouse is "jointly and severally liable" for any tax, interest and penalties attributable to the return. In other words, either spouse could be forced to shoulder the tax burden. This tax responsibility continues to apply if the couple subsequently gets a divorce.

In fact, the IRS may try to collect the full amount due from one spouse, even if all or most of the income reported on the joint return was earned by the other spouse. However, under the innocent spouse rules, an individual may avoid liability for unpaid tax and penalties, despite having signed a joint return, if the following requirements are met:

1. You filed a joint return, which has an understatement of tax.

2. The understatement of tax is due to erroneous items of your spouse.

3. You establish that at the time the joint return was signed, you did not know—or have reason to know—that there was an understatement of tax.

4. Taking into account all the facts and circumstances, it would be unfair to hold you liable for the understatement.

Now the IRS is making it easier to qualify for innocent spouse relief. The new notice includes the following changes and clarifications:

- The deadline for filing a request for relief under the innocent spouse rules changes from two years after the first collection activity by the IRS to the expiration of the statute of limitations for collection (or refund or credit).

- Currently, the tax liability must be attributable to a tax return item of the other spouse. The new notice provides that an exception will be available for times when fraud results in the understatement of tax or deficiency.
- The notice clarifies that no single factor, or majority of factors, will control the determination of whether relief is granted. Actual knowledge of the item giving rise to the understatement or deficiency will not be weighed more heavily than other factors.
- Minimum standards based on income, expenses and assets would be imposed to determine whether the requesting spouse would suffer economic hardship if the relief is not granted. Also, a lack of economic hardship will not count against a spouse requesting relief.
- Other changes relate to (1) the requesting spouse's reasonable expectations that the spouse would pay the liability on time, (2) legal obligations of both spouses to pay outstanding tax liabilities, (3) the requesting spouse's compliance with federal tax laws once relief is granted and (4) the availability of refunds.

The new notice follows another recent change in the innocent spouse rules. In 2011, the IRS eliminated a time limit that previously applied to requests seeking equitable relief. Previously, the request had to be made within two years of the IRS starting collection activities.

The latest changes may have a substantial impact. Do not hesitate to inquire about the effect of these new rules on your tax liability.

For instance, you might incur foreign income taxes through your mutual fund investments. Your broker will provide the necessary information on the appropriate tax forms.

For questions on the "Innocent Spouse Rule" don't hesitate to contact your Henry & Horne, LLP tax professional.

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