

Are You An "Innocent Spouse"? The IRS May Think So

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Did you file a joint income tax return with your spouse or former spouse only to find out later that he or she omitted income on the return?

Maybe, for example, Bob was skimming money off the top of his construction business and gambling it all away in Atlantic City. His wife Sue had no knowledge of these activities and signed joint returns that failed to report all of their income. A few years later, Bob and Sue are divorced, and Bob has relocated to unknown address. The IRS now discovers Bob's omitted income from the previous years. They want to collect, but can't find Bob, so they turn to Sue. Does Sue have to pay all of the unreported taxes?

Although when you file a joint income tax return, the law makes both spouses responsible for the entire tax liability, under some circumstances, a spouse may be entitled to relief under the innocent spouse provisions of the Internal Revenue Code. In general, innocent spouse relief comes in three varieties depending on the circumstances surrounding the unreported taxes.

1. The first type of relief applies when the "innocent spouse" is still married to the spouse who understated income. In this situation, the "innocent spouse" must not have known ("actual knowledge") or had reason to know ("constructive knowledge") of the items that gave rise to the omission. As to constructive knowledge, courts have placed a duty on the taxpayer to inquire if a reasonably prudent person in the taxpayer's position would have felt obligated to inquire. So if the spouse seeking relief was receiving lavish gifts like new cars and jewelry while the amount of income reported on the return remained the same, then that spouse probably should have inquired as to the income reported on the return. While the IRS and the courts carefully examine knowledge, both will also look to the "equities" or, in other words, the other facts and circumstances surrounding the omission, to determine whether it is fair to hold the requesting spouse liable for the understatement. For example, whether the requesting spouse was being physically abused by the other spouse when she signed the joint return.
2. The second type of relief applies if you are no longer married or have lived apart from your spouse for the entire 12 months before your innocent spouse request, then you may file under a different variety of innocent spouse relief. This variety is much more taxpayer

friendly, so if you can qualify for it, you should use it. The reason is that constructive knowledge has no bearing on the analysis; instead, the IRS must prove that you actually knew that your spouse was omitting income. This argument is a much more difficult burden for the IRS than proving that you should have known about the omission.

3. The final category of innocent spouse relief is general relief. Under this section, the IRS has discretion to relieve a spouse or former spouse from liability if fairness cries out to let him or her off the hook. It should be used when there is a matter of fairness that is not properly examined under the more structured tests above. Because you can file for innocent spouse relief under any or all of these varieties, a request under either of the first two varieties discussed should be backed up by a request under this section.

The final issue with innocent spouse relief is when can it be requested. The answer is pretty much anytime. You can request during examination, litigation, or within 2 years of the IRS' first contact with you during the collection process.

So if you believe a spouse or former spouse has failed to report all of his or her income on a joint return that you signed or the IRS has commenced an action against you for such an omission, then perhaps now is the time to consult with your attorney about seeking innocent spouse relief.