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Recent Tax Court Innocent Spouse Rulings Under Code Sec. 6015(f) Have Made Code Sec. 6015(b) and (c) Virtually Superfluous

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Eric L. Green and Carlton M. Smith examine three recent Tax Court opinions, raising the issue of whether Code Sec. 6015(b) and Code Sec. 6015(c) are still relevant.

A taxpayer seeking innocent spouse relief from tax debts attributable to joint return liabilities currently has three options for seeking relief: Code Sec. 6015(b)[1] (complete or partial relief from certain deficiencies), Code Sec. 6015(c) (separation of liability for deficiencies) and Code Sec. 6015(f) (equitable relief from deficiencies and underpayments).

Three recent Tax Court opinions have raised the issue of whether Code Sec. 6015(b) and Code Sec. 6015(c) are still relevant. We suggest that the answer is, in nearly all cases now, "no." Here's why:

Code Sec. 6015

In 1998, Congress was of three minds as to how to replace and expand the original "innocent spouse" provision (formerly contained at Code Sec. 6013(e)). There were different House and Senate versions of the bills providing for expanded coverage, and the Conferees couldn't decide which to choose. So, they created a new Code Sec. 6015 with both expanded versions and an extra provision for when a taxpayer could not win under either of the two other versions, but equity dictated that relief should still be given. Of course, this created a messy statute—hardly a model of clear thinking or drafting.

The first type of relief created under Code Sec. 6015 was similar to the prior innocent spouse provision at Code Sec. 6013(e), but slightly expanded. Under Code Sec. 6015(b), three conditions must be met: (1) there must be a tax "deficiency" (*i.e.*, the tax must have been understated) due to an erroneous item of the other spouse; (2) the spouse electing relief must not have known or had reason to know of the erroneous item; and (3) it would be "inequitable" to hold the electing spouse liable for the tax deficiency. Under case law under former Code Sec. 6013(e) (which was repealed), the courts had decided the third issue (inequity) largely on whether the spouse seeking relief had significantly befitted from the tax not paid because of the deficiency, whether he or she would undergo a hardship if now forced to pay, and the current marital status of the taxpayers.[2]

The second type of relief under Code Sec. 6015 was to be easier to get than that at Code Sec. 6015(b). So, it was made available only to spouses more likely to suffer—*i.e.*, those who were, at the time of the relief election, divorced, separated or living apart for at least 12 months. This second provision, at Code Sec. 6015(c), allows an electing spouse to obtain relief from a tax deficiency by allocating the deficiency between the spouses in proportion to whose items created the deficiency. Doing so should reduce the tax liability of the electing spouse roughly to the

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amount that he or she would have owed had he or she filed separately. The calculation splitting the deficiency usually gives about the same result as would be obtained under (b), so practitioners are usually indifferent about whether relief is awarded under (b) or (c). The big benefits of (c) over (b), though, are that, under (c), but not (b), (1) a taxpayer can obtain relief even if he or she had reason to know (but not actual knowledge) of the item giving rise to the deficiency; and (2) if the IRS wants to prevent (c) relief, the IRS must shoulder the burden of proof of showing that the electing spouse actually knew of the erroneous item—often a very difficult fact to prove.[3]

For both Code Sec. 6015(b) and (c), the taxpayer may make an election for relief (usually by filing a Form 8857) no later than two years after the start of any IRS collection activity. But, (b) and (c) may also be raised in a pre-assessment deficiency proceeding in the Tax Court (the place where repealed Code Sec. 6013(e) came up) or in the course of a Collection Due Process lien or levy hearing under Code Sec. 6320 or Code Sec. 6330.

Code Sec. 6015(f) was the third new provision. It simply states: "Under procedures prescribed by the Secretary, if—(1) 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); and (2) relief is not available to such individual under subsection (b) or (c), the Secretary may relieve such individual of such liability." Rev. Proc. 2003-61[4] lists factors that the IRS currently considers when making equitable relief determinations under Code Sec. 6015(f), including current marital status, economic hardship, knowledge, the spouses' legal obligation with respect to tax debts, if there was a significant benefit to the requesting spouse, if the requesting spouse was the victim of abuse and the requesting spouse's mental and/or physical health. All these facts and circumstances are considered together, but no one factor is determinative.

Thus, if a spouse who elected relief under (b) or (c) was denied relief because he or she knew or had reason to know of the item giving rise to the deficiency, he or she could still sometimes get relief under (f) by proving, say, hardship and lack of significant benefit. Initially, this presented a problem, though: Why even bother to elect relief under (b), since (1) while under both (b) and (f), one had to prove that it was inequitable to hold the spouse liable; and (2) only under (b) did the electing spouse also have to show that he or she had no knowledge or reason to know of the deficiency? Why not just skip arguing for (b) relief altogether?

There were two answers to these questions:

- First, the initial conclusion of the courts looking at (f) was that (f) granted the IRS discretion in deciding what was inequitable. Thus, courts held that they could review an IRS determination not to grant (f) relief due to inequity only on an "abuse of discretion" standard.[5] By contrast, under (b) and (c), the courts had held that they would decide the questions of knowledge and equity on a *de novo* legal standard.[6] Thus, a taxpayer had a lesser burden to prove inequity under (b) than under (f), since the courts would not defer to the discretion of the IRS's conclusion on the issue of inequity in a (b) case.
- The second answer goes to the mechanism by which Code Sec. 6015 relief could be raised when not in the course of a deficiency proceeding or in a Collection Due Process case. When Congress created the new section in 1998, it also added Code Sec. 6015(e), which allowed a taxpayer who filed a request for relief from a deficiency under (b) or (c) a special "stand-alone" proceeding in the Tax Court if the request was denied or ignored by the IRS for more than six months. A few years after the enactment of Code Sec. 6015, the IRS began to argue that, in a stand-alone proceeding brought in the Tax Court under (e), the Tax Court was limited to considering only the evidence that the taxpayer had submitted in the administrative proceeding before the IRS—*i.e.*, that the taxpayer could not introduce additional evidence before the Tax Court. Further, the IRS argued that the language of Code Sec. 6015(e) did not permit a stand-alone proceeding for the Tax Court to review IRS denials of requests for relief under (f).

In *G.A. Ewing*,[7] in 2002, the Tax Court held that it did have jurisdiction to decide the question of equitable relief under (f) in a stand-alone proceeding brought under the version of (e) in effect at that time. Ewing was not a case involving a tax deficiency, but rather one simply where the parties to the joint return did not send in checks with the return for the full balance due shown on the return. Equitable relief under (f) may be possible for such balance due liabilities, though it is not possible under (b) or (c) because (b) and (c) relief only apply where there is a deficiency (an understatement of the correct tax on the return).

Two years later, in the same *Ewing* case, the Tax Court also held that a stand-alone proceeding before

the Tax Court under (e) was a trial *de novo* in which the taxpayer could introduce testimony and other evidence that had not been presented to the IRS at the administrative level.[8] The Tax Court so held, in part, because it saw no reason that Congress would want the court to decide (b), (c) and (f) relief issues in deficiency proceedings through the traditional Tax Court trial *de novo,* but the same issues in stand-alone proceedings under (e) only on the administrative record. Further, the court pointed out that, if the IRS ignored a request for relief under (f), and the taxpayer brought a stand-alone proceeding under (e) after six months, there would be no administrative record for the court to review. The court saw no reason Congress would have wanted (f) relief to be decided by the Tax Court, in such a case, on the basis of no record at all.

The IRS appealed *Ewing* to the Ninth Circuit, which overruled the Tax Court on the issue of jurisdiction.[9] The Ninth Circuit held that the version of (e) then in effect did not allow for the Tax Court to decide (f) relief under a stand-alone petition. After so holding, the Ninth Circuit vacated the Tax Court's opinions in the case—thus leaving it unclear what the Tax Court would do as to the scope of trials in any stand-alone proceedings—even ones only arguing for (b) or (c) relief relating to deficiencies.

In response to the Ninth Circuit's opinion, later in 2006, Congress amended Code Sec. 6015(e) to explicitly give the Tax Court jurisdiction to decide the issue of (f) equitable relief, as well, in a stand-alone petition.[10] Then came Mrs. Porter and Cathy Lantz.

Porter ("Porter I")[11]

Mrs. Porter's husband received an IRA distribution and nonemployee compensation. The joint return filed by the Porters reported the IRA distribution and Mrs. Porter's wages, but did not report Mr. Porter's nonemployee compensation or the Code Sec. 72(t), 10-percent, pre–59 1/2 early withdrawal penalty on the IRA distribution. The IRS sent the Porters a notice of deficiency asserting a deficiency attributable to income and self-employment tax on the nonemployee compensation and a 10-percent early withdrawal penalty. Neither spouse petitioned the Tax Court, so the IRS assessed the deficiency and issued collection notices. At that point, Mrs. Porter filed a Form 8857 requesting relief under Code Sec. 6015(c) and (f).

The IRS Appeals Officer granted Mrs. Porter relief under (c) with respect to the portion of the deficiency attributable to her husband's nonemployee compensation, but denied relief from the Code Sec. 72(t) penalty because Mrs. Porter (1) knew of the premature distribution—it being shown on the return—and (2) knew that her husband had not reached 59 1/2. In response, Mrs. Porter brought a stand-alone petition under (e) in the Tax Court, arguing that, at least, she should be relieved from the penalty under (f) because she did not significantly benefit from the deficiency and it would be a hardship for her to pay it. In the Tax Court, the IRS first filed a motion *in limine* to exclude from the trial any evidence not contained within the administrative record. The court, revisiting in detail its reasoning in one of its vacated *Ewing* opinions, denied the IRS' motion and again held that the scope of the trial would be *de novo.* Thus, the court would allow in new evidence that was not part of the administrative record.

The Tax Court's holding in this case, known as *Porter I,* was endorsed earlier this year in a different case whose appeal was pending in a Court of Appeals. In *Neal,*[12] the Eleventh Circuit quoted extensively from the Tax Court's *Porter I* opinion and agreed with the Tax Court's conclusion about the scope of a Tax Court trial in a stand-alone proceeding—*i.e.,* the Tax Court may take in additional evidence. No other Circuit has faced this issue to date.

Porter ("Porter II")[13]

Mrs. Porter's case then proceeded to trial, where she testified. After trial, she argued that the Tax Court should review the IRS' denial of equitable relief under a *de novo* standard, not abuse of discretion. In *Porter II,* the majority opinion noted that the amendment to (e) made in 2006 primarily to clarify the Tax Court's stand-alone jurisdiction for (f) cases had also changed other language in the subsection. These changes, the majority felt, presented grounds for the Tax Court to reconsider its previous holdings (and those of several Courts of Appeals) that the Tax Court should review the IRS' denial of equitable relief under (f) under an abuse of discretion standard. After this reconsideration, the Tax Court agreed with Mrs. Porter that no deference should be given to how the IRS weighed the factors under the revenue procedure to reach the IRS' conclusion. Rather, the Tax Court should make its own conclusion as to equity using a *de novo* standard—just as the Tax Court would make its decision under a *de novo* standard if relief were at issue under (b) or (c). Using the *de novo* standard, the court held that Mrs. Porter was entitled to equitable relief under Code Sec. 6015(f) for the Code Sec. 72(t) early withdrawal penalty.

It should be noted that, while the Tax Court's ruling on its standard of review under (f) was issued in a stand-alone case brought under (e), nothing in the court's opinion limits its logic only to stand-alone (e) petitions. Thus, it appears that the Tax Court will always review (f) equitable relief determinations by the IRS on a *de novo* standard, whether the challenge arises in a deficiency, Collection Due Process or stand-alone proceeding. In no proceeding will the Tax Court use an abuse of discretion standard for (f) relief.

No Court of Appeals has yet considered whether it agrees or disagrees with this recent change of Tax Court precedent. One can anticipate that, at least for a few years, the Courts of Appeals may wrestle with whether they similarly have to overrule their "abuse of discretion" review standard for proceeding involving (f). But, it may not take so long: In July, the IRS let the time to appeal the *Porter* opinions expire without filing an appeal. This suggests that the IRS may not resist Courts of Appeals changing their precedent to agree with the Tax Court, though a Chief Counsel Notice issued on June 30, 2009, exhorts IRS attorneys to "raise the scope and standard for review arguments ... , noting the Service's disagreements with the holdings in the *Porter* opinions."[14]

C.M. Lantz[15]

Cathy Lantz and her husband, Dr. Richard Chentnik, filed a joint tax return for 1999. Dr. Chentnik was later convicted of Medicare fraud and sent to jail. The IRS then sent the spouses a notice of deficiency seeking a large tax deficiency and penalty with respect to 1999. Neither spouse responded to the notice of deficiency, so the IRS assessed the tax and penalty set forth therein. In 2003, while Dr. Chentnik was in jail, the IRS issued a notice of intention to levy for the 1999 liability, and Dr. Chentnik requested a Collection Due Process hearing. As a result of the hearing, the spouses were placed into currently not collectible status. During the CDP hearing, Dr. Chentnik did not himself raise any issue under Code Sec. 6015 or get his wife to request relief under Code Sec. 6015. In 2006, after Dr. Chentnik had died, the IRS applied an overpayment from Cathy Lantz' 2005 single return as a credit against the joint 1999 liability. This prompted her to file a Form 8857 electing and requesting relief under Code Sec. 6015(b), (c) and (f). The IRS denied her relief, noting that the Form 8857 was filed more than two years after the IRS had begun collection action (the notice of intention to levy). To get relief under Code Sec. 6015(b) and (c), the statute requires that an election be filed within the two-year period. While Code Sec. 6015(f) contains no such two-year limitation, Reg. §1.6015-5 also imposed the same two-year time period to request equitable relief under (f), and so the IRS also denied relief under (f). In response, Ms. Lantz filed a stand-alone petition in the Tax Court under Code Sec. 6015(e) now seeking relief only under Code Sec. 6015(f) and arguing that the regulation was invalid.

Noting that the two-year time period is only in the statute at Code Sec. 6015(b) and (c), the Tax Court stated that if Congress had wished to create a two-year requirement for requesting equitable relief, this language would have been reflected in Code Sec. 6015(f), as well. In addition, the court noted that imposing the same two-year time period for equitable relief seemed to contradict the thrust of Code Sec. 6015(f), which was to grant equitable relief, when necessary, over a longer time frame. The court held the regulation to be an invalid interpretation of Code Sec. 6015(f). Thereafter, the parties stipulated that it would be inequitable to hold Ms. Lantz liable for the deficiency in the particular circumstances of her case.[16]

Conclusion

By its recent *Porter I* and *Porter II* opinions, the Tax Court has created a situation where an election of relief from a deficiency under Code Sec. 6015(b) or (c) is virtually unnecessary. As noted above, prior to 2006, there were basically three reasons why (f) relief was potentially not as good as (b) or (c) relief: (1) Tax Court review of (f) relief was done only under an abuse of discretion standard; (2) it was unclear that the Tax Court could even review a denial of (f) relief in a stand-alone proceeding under (e); and (3) it was unclear whether, in a stand-alone proceeding, the taxpayer could expand on the administrative record and introduce new evidence. The Tax Court has now cleared up all these issues by holding that review under (f) is *de novo,* both as to scope of the Tax Court proceeding and the Tax Court's standard of review, and that the Tax Court has jurisdiction to decide (f) relief in a stand-alone proceeding. Moreover, (b) and (c) relief have to be elected within a two-year period after the IRS commences collection activity. But, now, by contrast, under *Lantz,* (f) relief, currently, can be raised at any time that the IRS is still seeking to collect the liability.[17]

This leads one to wonder why one would even seek to raise (b) relief anymore. Relief under (b) not only requires the taxpayer to prove all the factors going to inequity (the only issue under (f)), but also his or her lack of knowledge or reason to know of the item giving rise to the deficiency.

And, with respect to (c) relief, one can imagine very few situations where a spouse could get separation of deficiency liability relief, even though it was still equitable to hold her liable under (f). In a rare example, relief could be given under (c) if the taxpayer did not know of the erroneous item, even though he or she would suffer no hardship by being forced to pay the deficiency and significantly benefited from the deficiency. By contrast, under (f), those factors arguing against equitable relief (significant benefit and lack of hardship) might outweigh the factor arguing for equitable relief—*i.e.*, that the spouse did not know of the erroneous item. People raising innocent spouse relief even under (c), though, usually do so because of hardship and/or lack of significant benefit, as well. So, this is quite an uncommon example.

Indeed, the main reason still to raise relief under Code Sec. 6015(b) and (c) appears to be to protect one's client just in case a Court of Appeals reverses one of the Tax Court's recent rulings under (f).

Frankly, given the Tax Court's rulings, and if no Court of Appeals disagrees, it would now greatly simplify the statute to just repeal (b) and (c) entirely. Then, let (f)—the sole remaining avenue for innocent spouse relief—be shortened to read: "Under procedures prescribed by the Secretary, if, 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), the Secretary may relieve such individual of such liability." In this way, the Tax Court would (1) ignore what, if anything, the IRS was told at the administrative level, (2) merely take testimony and evidence on the factors for relief under (f) set out by the IRS in Rev. Proc. 2003-61, and (3) make its own facts and circumstances determination about what was equitable. The court and the parties could then save a lot of time thinking about—and a lot of ink writing about—the issues in (b) and (c) that do not anymore ultimately decide whether a spouse will be relieved of joint liability under Code Sec. 6015.

One could even simplify the statute further: The factors chosen by the IRS for consideration under (f) in the revenue procedure were largely taken from the case law under former Code Sec. 6013(e) deciding the issue of inequity under that provision. Why let the IRS decide what are the appropriate factors for inequity under (f), when those factors derived from case law in the first place? Why not just go back to the old case law as to what circumstances indicate inequity and devise new case law, as needed, to cover the few things (*e.g.*, underpayment cases not involving deficiencies) that are also now covered by (f) but were not by Code Sec. 6013(e)?

The Tax Court has not been fully deferential to the IRS' revenue procedures, anyway. For example, in *Ewing*,[18] the Tax Court refused to follow a predecessor of Rev. Proc. 2003-61 to the extent that the predecessor treated the absence of significant benefit as not a factor favoring equitable relief.[19] Rather, the Tax Court held that the absence of significant benefit under its old case law was a factor favoring a finding of inequity under Code Sec. 6013(e)(1)(D), so lack of significant benefit would be treated as a favorable factor for granting relief under Code Sec. 6015(f).

Thus, to simplify the statute even more and completely eliminate all deference to the IRS, why not amend Code Sec. 6015(f) to simply read: "If, 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), the individual shall be relieved of such liability"? Relief under current Code Sec. 6015(b), (c), and (f) would all be folded into this one sentence. After the recent opinions, that is largely what the Tax Court is now doing, anyway. Why not let the statute fully conform to the holdings and get rid of all this deadwood in Code Sec. 6015?

Endnotes

1 Unless otherwise indicated, all "Code Sec." references are to the Internal Revenue Code.

2 *See, e.g., R.J. Reser*, CA-5, 97-1 USTC ¶50,416, 112 F3d 1258.

3 Under (c), though, the spouses cannot have transferred any assets between them as part of a fraudulent scheme.

4 Notice 2003-52, 2003-2 CB 296.

5 *See, e.g., D.C. Johnson*, 118 TC 106, 125, Dec. 54,641 (2002), *aff'd*, CA-10, 2004-1 USTC ¶50,122, 353 F3d 1181; *K. Cheshire*, 115 TC 183, 198, Dec. 54,028 (2000), *aff'd*, CA-5, 2002-1 USTC ¶50,222, 282 F3d 326; *H.L. Mitchell*, CA-DC, 2002-2 USTC ¶50,475, 292 F3d 800, 807.

6 *S.L. Porter*, 132 TC No. 11 (Apr. 23, 2009). ("We have always applied a de novo scope and standard of review in determining whether relief is warranted under subsections (b) and (c) of section 6015. *See, e.g., Alt v. Commissioner*, 119 T.C. 306, 313-316 (2002), affd. 101 Fed. Appx. 34 (6th Cir. 2004).")

7 *G.A. Ewing*, 118 TC 494, Dec. 54,766 (2002).

8 *G.A. Ewing*, 122 TC 32, Dec. 55,519 (2004).

9 *G.A. Ewing*, CA-9, 2006-1 USTC ¶50,191, 439 F3d 1009.

10 Div. C, Act Sec. 408(a) of the Tax Relief and Health Care Act of 2006 (P.L. 109-432).

11 *S.L. Porter*, 130 TC 115 (2008).

12 *R.E. Neal*, CA-11, 557 F3d 1262.

13 *Porter, supra* note 6.

14 CC-2009-021, *reprinted at* 2009 TNT 125-5.

15 *C.M. Lantz*, 132 TC No. 8 (Apr. 7, 2009).

16 *Id.*

17 Absent certain tolling events, the IRS has 10 years to levy or bring suit for collection after it has assessed a liability. Code Sec. 6502(a).

18 *Supra* note 8, 122 TC, at 45.

19 *See* Rev. Proc. 2000-15, 2000-1 CB 447.