

## LR #4 INNOCENT SPOUSE RELIEF: Clarify That Taxpayers May Raise Innocent Spouse Relief In Refund Suits

### TAXPAYER RIGHTS IMPACTED<sup>1</sup>

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*

### PROBLEM

Under Internal Revenue Code (IRC) § 6015(e), the United States Tax Court (the Tax Court) has jurisdiction to review the IRS's denials of requests for innocent spouse relief. Even though taxpayers' right to petition the Tax Court under IRC § 6015(e) is "in addition to any other remedy provided by law," a federal district court refused to consider a taxpayer's innocent spouse claim in a refund suit arising under IRC § 7422. The court's refusal to allow a taxpayer to request innocent spouse relief in a refund suit may create hardship by forcing a taxpayer to seek relief in Tax Court, thus:

- Depriving the taxpayer of his or her right to a jury trial; and
- Depriving a successful taxpayer who makes a deposit to suspend the accrual of interest of the overpayment interest he or she would otherwise receive.

### EXAMPLE

In *Chandler v. U.S.*,<sup>2</sup> the IRS denied Ms. Chandler's request for innocent spouse relief from liability for taxes shown on a joint return. Ms. Chandler paid the tax and requested a refund from the IRS, which was denied. As authorized by IRC § 7422, Ms. Chandler brought a refund suit in a United States District Court, claiming that she was entitled to innocent spouse relief, and requesting a jury trial. The government sought dismissal of Ms. Chandler's complaint for lack of subject-matter jurisdiction, contending that the Tax Court has exclusive jurisdiction to review denials of innocent spouse relief. The district court agreed with the government and dismissed the case.

Following the dismissal of her case in district court, Ms. Chandler could have appealed the decision to a United States Court of Appeals.<sup>3</sup> She could not have obtained Tax Court review of the IRS's denial of her request for innocent spouse relief. The deadline for petitioning the Tax Court expired, and the Tax Court does not have jurisdiction to decide refund suits arising under IRC § 7422.<sup>4</sup>

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 2018 U.S. Dist. LEXIS 173880 (N.D. Tex. 2018), *adopting* 2018 U.S. Dist. LEXIS 174482 (N.D. Tex. 2018).

3 Notice of appeal is required within 60 days after the entry of judgment by the district court. Fed. R. App. P. 4(a)(1)(B). The district court in *Chandler* entered its judgment on Oct. 9, 2018. As of Dec. 13, 2018, it does not appear that an appeal had been filed.

4 Under IRC § 6015(e)(1)(A)(iii), the deadline for petitioning the Tax Court is 90 days after the IRS mails the taxpayer its final notice of determination.

## RECOMMENDATION

Amend IRC §§ 6015 and 66 to clarify that taxpayers are entitled to raise innocent spouse relief in refund suits arising under IRC § 7422.<sup>5</sup>

## PRESENT LAW

### The Internal Revenue Code Provides Taxpayers With Access to Various Judicial Fora

In general, the Tax Court is the only judicial forum in which a taxpayer can challenge the IRS's assertion that he or she is liable for a deficiency in tax before paying the asserted liability in full.<sup>6</sup> There is no right to a jury trial in Tax Court.<sup>7</sup> Until the Tax Court's decision in a deficiency case becomes final, interest and penalties continue to accrue with respect to the entire unpaid liability, if any, ultimately determined to be owed.<sup>8</sup> A taxpayer who obtains innocent spouse relief in Tax Court may be entitled to a refund to the extent permitted by IRC § 6015(g).<sup>9</sup> Interest on any refund would be payable at the rate of three percentage points above the Federal short-term rate.<sup>10</sup> A taxpayer may, without waiting for the outcome in Tax Court, make a deposit that will suspend the accrual of interest and penalties pending the outcome of the case.<sup>11</sup> If the taxpayer ultimately prevails in the Tax Court litigation, the deposit will be returned with interest at the Federal short-term rate.<sup>12</sup>

Rather than petitioning the Tax Court, a taxpayer may pay the asserted tax, which also suspends the accrual of interest and penalties, and then request a refund from the IRS.<sup>13</sup> Taxpayers who pay a proposed deficiency and whose claims for tax refunds have been denied by the IRS cannot bring refund suits in the Tax Court, but they may seek refunds in the United States district courts or in the United States Court of

5 For legislative recommendations relating to innocent spouse claims in collection proceedings, see National Taxpayer Advocate 2010 Annual Report to Congress 377 (Legislative Recommendation: *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*); National Taxpayer Advocate 2009 Annual Report to Congress 378 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions*); National Taxpayer Advocate 2007 Annual Report to Congress 549 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions*). The National Taxpayer Advocate reiterates her recommendations this year. See National Taxpayer Advocate 2019 Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* (Dec. 2018).

6 IRC § 6213(a). IRC § 6211(a) defines “deficiency” as the amount by which the correct tax exceeds the excess of: (1) the sum of the amount reported on the taxpayer's return for such tax if a return was filed and an amount of tax was reported on the return plus amounts previously assessed (or collected without assessment) as a deficiency, over (2) the amount of any rebates.

7 See, e.g., *Statland v. U.S.*, 178 F.3d 465, 472-473 (7th Cir. 1999).

8 See IRC § 6601, imposing interest on underpayments, generally running from the due date of return to the date the liability is paid. See also, e.g., IRC § 6662(b), imposing a 20 percent accuracy-related penalty on certain underpayments; under IRC § 6601(e)(2)(B), interest accrues on this penalty beginning on the date on which the return was required to be filed.

9 IRC § 6015(g) provides that “Except as provided in paragraphs (2) and (3), notwithstanding any other law or rule of law (other than section 6511, 6512(b), 7121, or 7122), credit or refund shall be allowed or made to the extent attributable to the application of this section.”

10 IRC § 6621(a).

11 IRC § 6603(b).

12 IRC § 6603(d)(4); IRC § 6621(b). *Minihan v. Comm’r*, 138 T.C. 1 (2012). Interest on the refund would be payable at the rate of three percentage points above the Federal short-term rate. IRC § 6621(a).

13 IRC § 6511.

Federal Claims.<sup>14</sup> A jury trial is available if the refund suit is brought in a United States District Court.<sup>15</sup> If an individual taxpayer ultimately prevails in the refund suit, his or her payment will be refunded together with interest at the rate of three percentage points above the Federal short-term rate.<sup>16</sup>

### The Innocent Spouse Rules Evolved Over Decades, but Access to More Than One Judicial Forum Remained Intact

IRC § 6013(e), enacted in 1971, provided relief from tax liability arising from filing a joint return with a spouse.<sup>17</sup> Relief was available to a requesting spouse where there had been an omission of income attributable to the other spouse of over 25 percent of the gross income shown on the return. The spouse seeking relief also had to show that he or she did not know or have reason to know of the omission, did not significantly benefit from it, and that it would be inequitable to hold the requesting spouse liable for the deficiency attributable to the omitted income.<sup>18</sup>

Taxpayers sought Tax Court review of the IRS's denial of their innocent spouse claims under the 1971 legislation by commencing deficiency proceedings in the Tax Court.<sup>19</sup> Taxpayers also sought innocent spouse relief in refund suits brought in other federal courts.<sup>20</sup>

With the Tax Reform Act of 1984, Congress expanded the relief available under IRC § 6013(e) to include any substantial understatement (*i.e.*, over \$500) attributable to a spouse's grossly erroneous items (including omissions of gross income and improperly claimed deductions) of which the taxpayer did not know or have reason to know.<sup>21</sup> At the same time, IRC § 66 was also amended to provide for relief from the liability that arises by operation of community property laws.<sup>22</sup>

Taxpayers continued to seek innocent spouse relief pursuant to amended IRC § 6013(e), not only in Tax Court deficiency proceedings, but also in refund suits they brought in other federal courts.<sup>23</sup>

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) again revised the innocent spouse provisions.<sup>24</sup> IRC § 6013(e) was repealed, and the innocent spouse rules are now found in IRC § 6015. IRC § 6015 provides three avenues for obtaining innocent spouse relief. Section 6015(b) provides "traditional" relief from deficiencies and is available to all joint filers regardless of marital status. Section 6015(c) provides relief from deficiencies for certain spouses who are divorced, separated, widowed, or not living together, by allocating the liability between each spouse. Section 6015(f)

14 IRC § 7422; 28 U.S.C. §§ 1346(a)(1) and 1491. Unlike in Tax Court, to receive judicial review of a tax liability in one of the refund fora, a taxpayer generally must first pay the disputed income tax in full and then file a claim for refund with the IRS. See *Flora v. U.S.*, 362 U.S. 145 (1960).

15 28 U.S.C. § 2402. There is no right to a jury trial in the United States Court of Federal Claims, *U.S. v. Sherwood*, 312 U.S. 584, 587 (1941); *Webster v. U.S.*, 74 Fed. Cl. 439, 444 (2006).

16 IRC § 6621(a).

17 See Pub. L. No. 91-679, 84 Stat. 2063-64 (1971) (adding IRC § 6013(e)).

18 IRC § 6013(e)(1)(A)-(C), as enacted by Pub. L. No. 91-679.

19 IRC § 6213. See, e.g., *Sonnenborn v. Comm'r*, 57 T.C. 373 (1971). The new law applied retroactively to all tax years subject to the Internal Revenue Codes of 1939 and 1954. Pub. L. No. 91-679, § 3.

20 See, e.g., *Sanders v. U.S.*, 509 F.2d 162 (5th Cir. 1975) *aff'g* 369 F. Supp. 160 (N.D. Ala. 1973).

21 Pub. L. No. 98-369, Div. A, § 424(a), 98 Stat. 801 (1984). To qualify for relief, the substantial understatement had to exceed 25 percent of the spouse's adjusted gross income (ten percent if the adjusted gross income was \$20,000 or less).

22 Pub. L. No. 98-369, Div. A, § 424(b), 98 Stat. 801 (1984). Spouses who live in community property states and file separate returns are generally required to report one-half of the community income on their separate returns. *Poe v. Seaborn*, 282 U.S. 101 (1930).

23 See, e.g., *Farmer v. U.S.*, 794 F.2d 1163 (6th Cir. 1986); *Mlay v. IRS*, 168 F. Supp. 2d 781 (S.D. Ohio 2001).

24 Pub. L. 105-206, § 3201(a), (b), 112 Stat. 685 at 734, 739.

provides “equitable” relief from both deficiencies and underpayments, but only applies if a taxpayer is not eligible for relief under IRC § 6015(b) or (c). RRA 98 also amended IRC § 66(c) to provide for equitable relief to taxpayers in community property states.

RRA 98 also enacted IRC § 6015(e), which specified that Tax Court review was available with respect to denials of innocent spouse relief under IRC § 6015 (b) or (c), or where the IRS failed to make a determination within six months after relief was requested.<sup>25</sup> In addition, IRC § 6015(e)(3)(C) provided that if either joint filer brought a timely refund suit while an innocent spouse claim was pending in Tax Court, then the Tax Court was deprived of jurisdiction and “the court acquiring jurisdiction shall have jurisdiction over the petition filed under this subsection.”<sup>26</sup>

Further amendments to IRC § 6015(e)(1)(A) in 2001 clarified that Tax Court review of innocent spouse determinations is “in addition to any other remedy provided by law.”<sup>27</sup> As the Conference Report on the 2001 legislation noted:

*Non-exclusivity of judicial remedy.*—Some have suggested that the IRS Restructuring Act administrative and judicial process for innocent spouse relief was intended to be the exclusive avenue by which relief could be sought. The bill clarifies Congressional intent that the procedures of section 6015(e) were intended to be additional, non-exclusive avenues by which innocent spouse relief could be considered.<sup>28</sup>

Following the 1998 and 2001 legislation, at least one federal court considered a taxpayer’s claim for innocent spouse relief in a refund suit, consistently with IRC § 6015(e)(1)(A).<sup>29</sup> The Tax Relief and Health Care Act of 2006 amended IRC § 6015(e) to expressly provide that the Tax Court has jurisdiction in “stand alone” cases to review IRC § 6015(f) determinations, even where no deficiency has been asserted, but did not affect the provisions of IRC § 6015(e)(1)(A).<sup>30</sup>

### A District Court Recently Held It Did Not Have Jurisdiction to Decide an Innocent Spouse Claim in a Refund Suit

In *Chandler v. U.S.*, the district court refused to consider a taxpayer’s claim for innocent spouse relief in a refund suit, holding that the Tax Court has exclusive jurisdiction to review the IRS’s denial of requests

25 Pub. L.105-206, § 3201(a), 112 Stat. 685 at 734.

26 *Id.* In hearings that preceded the enactment of RRA 98, at least one witness expressed reservations about this provision, noting that requiring removal of an innocent spouse case from the Tax Court simply because of an act by the other spouse “is to perpetuate the situation that brought her to the Tax Court in the first place.” *IRS Restructuring Hearings: Hearing Before the Sen. Comm. on Finance, 105th Cong., 2nd Sess. 126* (Feb. 5, 1998) (statement of Nina E. Olson, Executive Director, The Community Tax Law Project). IRC § 6015(e)(3)(C) now appears as IRC § 6015(e)(3).

27 Community Renewal Tax Relief Act of 2000, Pub. L. 106-544, App’x G, § 313(a), 114 Stat. 2673, 2763A–641 (2001), amending IRC § 6015(e)(1) to read as follows: “(A) IN GENERAL.—In addition to any other remedy provided by law, the individual may petition the Tax Court (and the Tax Court shall have jurisdiction) to determine the appropriate relief available to the individual under this section if such petition is filed—

(i) at any time after the earlier of—

(I) the date the Secretary mails, by certified or registered mail to the taxpayer’s last known address, notice of the Secretary’s final determination of relief available to the individual, or

(II) the date which is 6 months after the date such election is filed with the Secretary, and

(ii) not later than the close of the 90th day after the date described in clause (i)(I).”

28 H.R. REP. No. 106-1033, at 1023 (2000) (Conf. Rep.).

29 See, e.g., *Flores v. U.S.*, 51 Fed. Cl. 49 (2001).

30 Pub. L. No. 109-432, Div. C, § 408(a), (c), 120 Stat. 2922, 3061-62 (2006), amending IRC § 6015(e)(1) to provide: “In the case of an individual against whom a deficiency has been asserted and who elects to have subsection (b) or (c) apply, or in the case of an individual who requests equitable relief under subsection (f)—” (emphasis added).

for innocent spouse relief.<sup>31</sup> The court relied on decisions by other courts that refused to allow taxpayers to seek innocent spouse relief in collection proceedings brought in federal courts.<sup>32</sup> The National Taxpayer Advocate believes the line of cases the *Chandler* court relied on were incorrectly decided. For over ten years she has recommended legislation to clarify that the Tax Court does not have exclusive jurisdiction to decide innocent spouse cases and that taxpayers may seek innocent spouse relief in suits brought in other federal courts.<sup>33</sup>

## REASONS FOR CHANGE

Notwithstanding IRC § 6015(e)(1)(A), which provides that an individual who seeks relief from joint liability may petition the Tax Court “in addition to any other remedy provided by law,” in 2018 a district court held that taxpayers cannot seek relief under IRC § 6015 in a refund suit. Other district courts have for decades allowed the claim in refund suits. The *Chandler* case adds to existing confusion about the extent to which taxpayers may seek innocent spouse relief in a judicial forum other than the Tax Court.

The decision in *Chandler*, by foreclosing district court review of innocent spouse claims, leaves taxpayers with only one forum—the Tax Court—in which to seek review of the IRS’s decision to deny their claims. Because there is no right to a jury trial in Tax Court, the *Chandler* decision also forecloses taxpayers’ right to have their cases decided by a jury.

The *Chandler* decision also forces taxpayers who make deposits to suspend the accrual of interest and penalties while their claims are decided in the Tax Court to forego three percentage points of interest if they prevail in Tax Court and are entitled to the return of their deposit.

Even if a different taxpayer in the same situation were to appeal the outcome in the *Chandler* case to a United States Court of Appeal and prevail, the appellate court’s decision would be binding precedent only with respect to district courts within the jurisdiction of that Court of Appeals. Taxpayers need clarification that the defense may be raised in collection suits in any district court.

## EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate’s recommendation will clarify that, consistent with the statutory language of IRC § 6015 and with judicial precedent, taxpayers may seek innocent spouse relief under IRC §§ 66 and 6015 in refund suits. Clarification will avert further confusion as to whether seeking innocent spouse relief is allowable in federal courts and will provide uniformity among district courts.

31 *Chandler v. U.S.*, 2018 U.S. Dist. LEXIS 173880 (N.D. Tex. 2018) adopting 2018 U.S. Dist. LEXIS 174482 (N.D. Tex. 2018).

32 Cases the court relied on include *U.S. v. Boynton*, 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007); *U.S. v. LeBeau*, 109 A.F.T.R.2d (RIA) 1369 (S.D. Cal. 2012); and *U.S. v. Elman*, 110 A.F.T.R.2d (RIA) 6993 (N.D. Ill. 2012).

33 National Taxpayer Advocate 2010 Annual Report to Congress 377 (Legislative Recommendation: *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*); National Taxpayer Advocate 2009 Annual Report to Congress 378 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions*); National Taxpayer Advocate 2007 Annual Report to Congress 549 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions*). The National Taxpayer Advocate reiterates her recommendations this year. See National Taxpayer Advocate 2019 Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* (Dec. 2018).