

4.02 Is the IRS Bluffing?

Sometimes cases involve an omission of income by the nonrequesting spouse and the IRS grants relief under section 6015(c) to the requesting spouse. Now, of course, it is usually beneficial if the IRS grants relief from a joint liability, but not in all cases. Sometimes the IRS grants relief under subsection (c) when the requesting spouse might qualify for relief under section 6015(b). What difference does it make? The difference is that unlike section 6015(b) which allows for the recovery of refunds, if relief is granted under section 6015(c), the statute bars the requesting spouse from recovering a refund. I.R.C. § 6015(g)(3).

Consider this scenario. Ron, a self-employed truck driver and Linda, a waitress, were married. Ron and Linda lived together until May 2006 when Linda moved out because Ron was physically abusive. At this time, she got an order of protection. After the taxable year ended, they filed a joint return because Linda thought married couples were required to file a joint return. In July 2007, they were divorced. Later in 2007, the IRS informed Ron and Linda that they owed additional taxes because Ron failed to report \$14,000 in income from three Form 1099's on the 2006 joint return. Linda maintains that she had no knowledge of the unreported income. Ron actually reported \$30,000.00 in self-employment income on the return and this amount was similar to the income he reported in earlier years. The IRS ultimately assessed \$6,000.00 in additional taxes and took Linda's next two refunds. Each refund was primarily due to the earned income tax credit and was for approximately \$2,500.00.

Linda filed a Form 8857 claiming innocent spouse relief under all three subsections of section 6015. She indicated that she had no knowledge of the items of omitted income, that she did not live with Ron for the last seven months of 2006 and that she was physically abused during their marriage. The IRS issued a final determination letter denying relief under section 6015(b), but granting relief under section 6015(c). The final determination letter also indicated that no refunds were allowable because relief

was granted under I.R.C. section 6015(c). Thus, if no further action is taken, Linda will not have to pay the balance due (\$1,000.00), but she will end up having paid \$5,000.00 of the \$6,000.00 liability.

Is there an issue here? Possibly. The issue is whether a reasonable person in Linda's position would have "had reason to know" of the unreported income. In the final determination letter, the IRS denied relief under section 6015(b), but granted relief under section 6015(c). This has a substantial impact on the knowledge issue. By denying relief under section 6015(b), the IRS position must be that Linda either knew or had reason to know of the understatement. But, by granting relief under I.R.C. § 6015(c), the IRS concedes that it did not have proof that Linda had actual knowledge of the omission of income. Combining the two positions taken by the IRS leaves the IRS with the fragile position that at the time Linda signed the return she had reason to know there was an understatement. I.R.C. § 6015(b)(1). What can be done here? If the representative is satisfied that Linda did not have reason to know, then he or she can file a petition for a redetermination of the denial of relief under section 6015(b).

How do you go about showing that Linda is eligible for relief under section 6015(b)? The first step is to use informal discovery followed by formal discovery. You need to ask the IRS what information it possesses that shows that Linda knew or had reason to know that Ron failed to report income.¹ You already know that the IRS does not possess proof of actual knowledge, because they would have denied relief under section 6015(c) if they did. Requesting the IRS to disclose the proof that Linda had reason to know will expose any weaknesses in the IRS position on knowledge. What can the IRS say? That a reasonable person should have known that Ron was underreporting his income. In response, you can offer Linda's testimony to prove that a reasonable person in her circumstances would not have known of the omission. Linda

¹ Among the documents that you might request are the "Appeals Transmittal and Case Memo". This document should show what information the IRS considered regarding knowledge. See *infra*, § 9.02 Discovery.

will testify that she was physically abused, moved out of the house in May of 2006 and had very poor communications with him the remainder of the year.² She will further testify that she had no knowledge of the omitted income. Thus, in contrast to the IRS hypothetical person who had reason to know, you can put a credible witness on the stand and it is more than likely the judge will agree with the witness. In Linda's case, such an effort can mean the return of \$5,000.00 plus interest. See Simmons v. Commissioner, T.C. Summ. Op. 2009-6.

² The Court will place the reasonably prudent person in the particular circumstances of the taxpayer. See Aude v. Commissioner, T.C. Memo. 1997-478, holding that a spouse living in a household in which the other spouse is threatening and intimidating her met her duty of inquiry even though she did not review the returns or make inquiries.