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Tax Regs in Plain English

# IRS Restructuring and Reform Act of 1998

## 3201 - Relief from Joint & Several Liability on Joint Return

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### Section 3201

**A. Provision(s) covered:** Section 3201 Relief from Joint and Several Liability on Joint Return [Enacting Code § 6015 & amending Code § 66]

**B. Background:** To qualify for relief from joint and several liability under current law, a joint return filer has the burden of proving that all of the following statutory requirements have been met:

1. a joint return was filed for the taxable year;
2. the joint return contains a substantial understatement of tax attributable to a grossly erroneous item of the other spouse (substantial means in excess of the greater of \$500 or a specified percentage of the innocent spouse's adjusted gross income for the most recent year);
3. the taxpayer did not know, and had no reason to know, of the substantial understatement when he or she signed the joint return; and
4. it would be inequitable to hold the taxpayer liable for the deficiency in income tax attributable to such substantial understatement.

**C. Changes:** There are three ways to obtain relief: Expanded Innocent Spouse Relief, Separate Liability Election, and Equitable Relief.

Expanded Innocent Spouse Relief (Rule I): The present rule is amended by relaxing

requirement (2), above. The understatement need not be substantial and the item need only be erroneous (and not grossly erroneous). Also, if a taxpayer knew of an understatement, but not its extent, he or she may be relieved of the portion of the liability that is attributable to the part of the understatement he or she did not know about and had no reason to know about.

**Separate Liability Election (Rule II):** A qualified taxpayer may elect (in addition to electing relief under Rule I) to have the liability for any deficiency limited to the portion of the deficiency that is attributable to items allocable to that taxpayer under special rules. In general, the items are allocated as if the taxpayers had filed separate returns (but the Secretary shall prescribe other allocation methods). To qualify, at the time of the election the taxpayer must be either: (i) no longer married to, (ii) legally separated from, or (iii) living apart for at least 12 months from, the person with whom the taxpayer originally filed a joint return. The burden is on the taxpayer electing relief to establish the allocation. The election is not available if the Secretary shows that assets were transferred between the joint filers as part of a fraudulent scheme, or that the electing taxpayer had actual knowledge of the understatement (unless the taxpayer signed under duress). Also, the portion of the deficiency for which the electing spouse is liable is increased by the value of any "disqualified assets" received from the other spouse. (A "disqualified asset" is one transferred with the principal purpose of avoiding tax or the payment of tax.)

**Equitable Relief (Rule III):** Under procedures prescribed by the Secretary, a taxpayer may request equitable relief. Primarily, this relief is to be available where tax was shown on a joint return, but not paid with the return; e.g., the taxpayer did not know or have reason to know that funds intended for the payment of the tax were taken by the other spouse for that spouse's benefit. However, relief is also to be available where there is an understatement of tax for which relief under Rules I and II are not available. These procedures (Rule III) are not effective until guidance is issued by Treasury and the Service.

Also, under procedures prescribed by the Secretary, an individual filing a separate return in a community property state may obtain equitable relief.

*Period for making election:* A taxpayer must elect Rule I or II no later than 2 years after the Commissioner begins collection activities. (The Secretary may adopt the same period for Rule III.) The legislative history provides that the period should begin when collection activities have been undertaken against the electing spouse that have the effect of giving that spouse notice of the Service's intention to collect the joint liability from such spouse; e.g., a levy on wages or the service of a notice of intent to levy against the property of the electing spouse; but not simply mailing a notice of deficiency and a demand for payment that is addressed to both spouses. With respect to deficiencies that are unpaid on the date of enactment, the period does not expire until 2 years after the date of the first collection activity after the date of enactment.

*Tax Court review:* A taxpayer may petition the Tax Court within 90 days after the Service mails (by registered or certified mailing) a notice denying relief requested under

Rule I or II. (If the Service does not act within six months of the request for relief, the taxpayer may petition anytime after that period.) The Tax Court must establish rules for notifying the other joint filer of a proceeding and providing that filer with the opportunity to become a party.

*Suspension of collection actions and statute of limitations:* As with other Tax Court proceedings, no levy or proceeding to collect in court shall be made until the 90 day period expires or the Tax Court decision becomes final, unless the collection of the tax is in jeopardy. Also, the statute of limitations on collection is suspended during the period in which collection is prohibited and for 60 days thereafter.

#### **D. Impact:**

1. There may be substantial demands made on resources because it is expected that a larger number of taxpayers will seek relief under the new rules than under the old rules because the new rules are more liberal than the old rules.
2. A large number of taxpayers already in the collection stream will be entitled to seek relief because the rules apply not only to any liabilities arising after the date of enactment, but also to liabilities that are unpaid on that date.

#### **E. Necessary Actions**

1. Send any notice relating to a joint return under § 6013 of the Code separately to each individual filing the joint return. [Submission Processing, Exam, Collection]
2. Create a separate form with instructions for requesting relief and have it available 180 days after enactment, and also revise numerous publications. [Tax Forms & Publications]
3. Issue regulations to provide (1) methods for allocation and (2) notice of and opportunity to participate in an administrative proceeding with respect to an election. [Chief Counsel]
4. Clarify the tests under Rule 1 for requirement (2) (knowledge of understatement) and requirement (3) (inequitable to hold liable) to promote consistency in their application. [Chief Counsel]
5. Prescribe procedures for obtaining equitable relief under IRC §§ 6015(f) and 66(c). [Chief Counsel] In the meantime, temporary procedures for screening such requests may be needed. [Exam, Appeals, Collection]
6. Decide which function or functions will evaluate requests for relief; i.e., Exam, Collection, Appeals.
7. Modify information systems to accommodate the separate tax accounts to be maintained in place of a joint tax account or to allow a joint tax account to be divided into two subaccounts. [Information Systems]
8. Review current training materials to ensure they stress the responsibility of telephone assistants, examiners, and collection personnel to identify situations where the innocent spouse provisions might apply, even if the taxpayer does not know about the provisions. [Customer Service, Exam, Appeals, Collection]
9. Coordinate with Tax Court on its development of new rules. [Chief Counsel]

**F. Other Special Comments:** Issues to be addressed:

1. The Service will define a bright line test for when collection activity begins.
2. The Service will provide a list of factors that will be taken into account regarding equitable relief.
3. Guidance will be provided as to whether the Service or the Tax Court subsequently deny relief if the Service discovers a fraudulent transfer after relief has been provided administratively or through a Tax Court decision.
4. Guidance will be provided as to whether a taxpayer may seek relief under the new provision if a court's decision to deny relief under the old law is final, but two years have not elapsed since the collection action began.

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