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Divorce and Taxes: What Happens When Love Leaves You a Liability?

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We remember it as clearly as the day it happened to each of us many, many years ago—everyone asking us if we felt different now that we were married and what attributed to our afterglow. As tax attorneys, our obvious answer was, “I feel the same, but now I can file jointly on my taxes, and we cannot be forced to testify against each other as a married couple.” Luckily, our husbands knew what they were marrying, but others just grimaced and slowly backed up away from us. We would like you all to know that each of us is still happily married to our significant other, we still file jointly, and nobody has asked us to testify against our husbands. So, win, win.

But realistically, roughly 35 to 50 percent of couples divorce each year, with one spouse walking away with a house, another with a car, and possibly both with a joint tax liability. We often get calls from newly divorced men and women asking about their options for a liability that was mainly generated by their former spouse. There are obvious options such as (1) an installment agreement, (2) an offer in compromise, or (3) moving to a foreign country and going underground. However, many times, the things that led an individual not to timely file or timely pay were outside of this individual’s control, such as abuse, fraud, and nefarious dealings by the other spouse. This puts individuals in a predicament for a liability that they did not sign off on, generate the income related to, or even know about. Why should they be stuck for a liability when they were in a situation that they could not control?

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Innocent Spouse Application

There is an option available to these individuals called an innocent spouse application that is offered on both the federal and state sides. Individuals will fill out a form for the related tax liability years stating why they believe that they should not be liable for the related penalties, interest, and tax. On the federal side, Form 8857 can grant the following types of relief: (1) innocent spouse relief, (2) separation of liability relief, (3) equitable relief, and (4) relief from liability for tax attributable to an item of community income. Each type of relief has a separate requirement to qualify.

Innocent Spouse Relief

For innocent spouse relief, you must file a joint return with an understatement of tax due to erroneous items of your spouse. As long as you can show that you didn't know or didn't have reason to know that this understatement existed, the Internal Revenue Service (IRS) could consider it to be unfair to hold you liable. The hardest part, of course, is showing that you had no "reason to know" that the understatement existed. Most taxpayers do not know of the error, but if the IRS determines that the couple lives in a \$10 million mansion, owns a private jet, and drives a Ferrari while signing a tax return that earned \$50,000, it is unlikely the IRS will believe that the "innocent" spouse had no reason to know that the return was false.

Separation of Liability Relief

To qualify for the second type of relief, separation of liability relief, you must no longer be married to or at least must be legally separated from the spouse with whom you filed the joint return, and you must not have transferred assets to each other.

Equitable Relief

The third type of relief, equitable relief, unlike innocent spouse relief or separation of liability relief, allows equitable relief from an understated tax or an unpaid tax. An unpaid tax is an amount of tax you properly reported on your return but have not paid. For example, your joint 2020 return shows that you and your spouse owed \$50,000. You paid \$20,000 with the return. You have an unpaid tax of \$30,000. The income tax liability from which you seek relief is attributable (either in full or in part) to an item of your spouse (or former spouse) or an unpaid tax resulting from your spouse's (or former spouse's) income. If the liability is partially attributable to

you, then relief can only be considered for the part of the liability attributable to your spouse (or former spouse).

Relief from Liability for Tax Attributable to an Item of Community Income

The fourth type of relief is related to tax-attributable community property items from which income has been generated. In order to file an innocent spouse application for relief from community property income tax, you must demonstrate that you are not responsible for the tax related to an item of community income if *all* of the following conditions exist:

- You did not file a joint return for the tax year.
- You did not include the item in gross income on your separate return.
- Under Section 879(a), the item was income that belonged to your spouse or former spouse. (For details, see Community Property Laws in [I.R.S. Pub. 971](#) (Dec. 2021).)
- You establish that you did not know of, and had no reason to know of, that item.
- Under all facts and circumstances, it would not be fair to include the item in your gross income.

Be aware that regardless of which relief request you are making, the IRS is required to try to contact your former spouse; there are no exceptions to this, even if you were a victim of abuse.

The Filing Process and Timeline

When we prepare this form, we attach exhibits, a detailed accounting of the time period related to the filing and assessment of the liability, the applicable tax returns, and the form in order to make sure that the reviewing party receives a clear picture of the facts and circumstances surrounding the request for relief from the liability. On the federal side, you are assigned an agent who will work on your case, send you physical updates, and request additional information if necessary to complete the review of your request. As with all things, should you be denied, you do have the right to appeal if you feel the decision was made in error or you have found additional information supporting your request.

The typical timeline to have a decision entered is around 12 to 18 months on the federal side and our state's side (California). This can be done quicker if you happen to be in U.S. Tax Court, as you have a timeline due to the scheduling of the trial and an attorney assigned who is watching your matter.

So, if you have recently gotten divorced and found out that your ex-spouse has an offshore account that was never reported on your joint tax returns or is a Nigerian prince who had funds submitted through Venmo that were not reported, and now you are stuck with that assessed liability, give this option some thought and contact a local tax attorney to get that story down on paper and submitted.

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