

Seventh Circuit Upholds Limitation Period for Seeking Equitable Innocent Spouse Relief

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Written By:
Thomas R. Wechter

On June 8, 2010, the Seventh Circuit in *Cathy Marie Lantz v. Commissioner*, Docket No. 09-3345, reversed the Tax Court's decision invalidating the Internal Revenue Service (IRS) regulation, Section 1.6015-5(b)(1), which imposes a two-year limitations period for seeking equitable innocent spouse relief.

Innocent Spouse Provisions

The innocent spouse provisions in their present form were enacted in the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 as three separate provisions for a spouse filing a joint return to obtain relief:

1. *Code section 6015(b)* provides innocent spouse relief where an understatement of tax is attributable to erroneous items of one spouse and the other spouse claiming relief did not know or have reason to know of the understatement and taking into consideration all of the facts and circumstances it would not be equitable to hold the other spouse liable.
2. *Code section 6015(c)* provides taxpayers who are no longer married, are legally separated or not living together an election to compute the liability of each spouse as if the spouses had filed separate returns for the taxable year. Section 6015(f) provides general equitable relief, if under the facts and circumstances it would not be equitable to hold one spouse liable for any under statement or underpayment and if relief is not available under the other sections. Code sections 6015(b) and (c), provide that relief by a spouse must be elected not later than the date that is two years after the IRS commencement of collection activities against the spouse.
3. *Code section 6015(f)* provides no specific time period within which the requesting spouse must seek relief, but the IRS has promulgated regulations that impose the same two year limitations period as imposed by the other sections.

The Facts of Lantz

In *Lantz*, the taxpayer had filed a joint income tax return for 1999 with her husband. The taxpayer was a "financially unsophisticated woman", who had attended only one year of college and did not work outside the home. The amount of taxes shown on the joint return was paid in full. In 2000, the taxpayer's husband was convicted and imprisoned for Medicare fraud. As a result of the husband's fraud, the IRS determined that the couple had understated their income on their 1999 joint return and assessed them more than \$900,000 in additional taxes, interest and penalties.

In 2003, during her husband's incarceration, the taxpayer received from the IRS a notice of intent to levy on her and her husband's property and instructions for filing a form for a due process hearing and general information regarding innocent spouse relief. The taxpayer relied upon her husband to return the form requesting a due process hearing and to obtain the form for her to seek innocent spouse relief. Before filing the form on behalf of his wife, the taxpayer's husband died.

It was not until three years later, when a refund due the taxpayer was applied to the outstanding tax liability from the joint return year, that the taxpayer discovered that the matter had not been taken

care of by her now deceased husband. A short time later, she applied for innocent spouse relief by filing Form 8857. At the time, the taxpayer was “unemployed and impecunious.” The IRS reject the taxpayer’s claim as untimely, although admitting that but for the regulations, the taxpayer would be eligible for relief.

Tax Court Proceedings in *Lantz*

The taxpayer filed a petition with the Tax Court seeking innocent spouse relief. In response, the Commissioner raised the two year statute in the regulations and argued that the taxpayer’s request for equitable innocent spouse relief under Section 6015(f) was untimely. The Tax Court, over a strong dissent, held that the regulation section imposing a two year limitations period for seeking equitable innocent relief under Section 6015(f) was invalid. The Tax Court applied the two step test of *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 487 U.S. 837 (1984) to determine whether the regulation was to be given deference. Finding that Congress by omitting the two year period in equitable relief section, but including it in the other sections had spoken on the issue by “audible silence”, the Tax Court held the equitable relief section was not ambiguous and therefore, the regulation was invalid.

If the statute is found to be ambiguous, the second step of the test is to determine whether the regulation is a permissible construction of the statute. Although the Tax Court had already found the statute not to be ambiguous, it also concluded that the regulation was not a permissible interpretation of the statute because it was contrary to Congress’s intent in omitting a limitations period in that section.

One dissenting opinion found that the regulation was ambiguous since Congress’s silence did not speak directly to the issue and that the regulation was a permissible construction of the statute. Another dissenting opinion pointed out that the taxpayer, although she failed to meet the two-year statute of limitation in the regulations, could also seek relief under section 301.9100-3, which gives the Commissioner discretion to grant extensions to make regulation elections.

The Seventh Circuit in *Lantz*

Demonstrating the expansive deference that circuit courts give administrative regulations, the Seventh Circuit reversed the Tax Court and held that the regulation was valid and a reasonable interpretation of the equitable relief statute. Judge Posner, writing the opinion, stated that the circuit “would not accept audible silence as a reliable guide to congressional meaning”. Posner went on to find that since the equitable relief section is discretionary, the section itself presumes “the power to make such exclusions is implicit in the grant of rulemaking authority”. He further added that when Congress gives an agency a blank check in the form of discretionary relief, “one of the blanks on the check is the deadline for applying for such relief.”

There are many nits in Judge Posner’s opinion and some flaws but the most serious is the writing of the word “equitable” out of the statute and the pointing to another remedy possibly available to the taxpayer to prevent collection of the joint tax liabilities by seeking a release of a levy because of

economic hardship pursuant to Code Section 6343(a)(1). Posner thought that since the taxes owed by the husband were currently not collectible from her husband who was deceased, the taxpayer should be entitled to relief under Section 6343(a)(1). Obviously recognizing the equities involved, Posner gratuitously states that “[s]he is entitled *a fortiori* to such relief [referring to Section 6343(a)(1) relief] and there is no deadline for seeking it. We can at least hope that the IRS knows better than to try to squeeze water out of a stone.”

There are at least two other cases involving the validity of the two year limitations period regulation on appeal. One, the Coulter case, is in the Second Circuit and the other, the Mannella case, is in the Third Circuit,.

Conclusion

It is hard to imagine that Congress, having explicitly included a two year limitation period for Sections 6015(b) and (c) , intended by its omission of a time period for equitable relief under Section 6015(f) that the time period should be limited to two years. This is especially true in light of the nature of the equitable relief, which acts as a safety valve and would be expected to be broader than the other forms of relief.

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