

New York State Bar Association

One Elk Street, Albany, New York 12207 • 518/463-3200 • <http://www.nysba.org>

Tax Report #960



TAX SECTION

1999-2000 Executive Committee

HAROLD R. HANDLER
Chair
Simpson Thacher & Bartlett
425 Lexington Avenue
New York, NY 10017
212/455-3110

ROBERT M. SCARBOROUGH
First Vice-Chair
212/277-4000

ROBERT A. JACOBS
Second Vice-Chair
212/530-6664

SAMUEL J. DIMON
Secretary
212/450-4037

COMMITTEE CHAIRS:

Bankruptcy and Leases
Sauri J. Goldring
David R. Siculer

Beals and Cost Recovery
Eliot Fleiss
Joel Scherstein

CLE and Pro Bono
James A. Locke
Victor Zonana

Compliance, Practice & Procedure
Robert S. Fink
Arnold Y. Kapiloff

Consolidated Returns
Ann-Elizabeth Purinton
David Flewman

Corporations
Andrew N. Berg
Dana Trier

Employee Benefits
Robert C. Feder
Barbara Nims

Estate and Trusts
Michael Katz
Ceryn S. McCallrey

Financial Instruments
David R. Steinberg
Lewis R. Steinberg

Financial Intermediaries
Bruce Kaye
Andrew Solomon

Foreign Activities of U.S. Taxpayers
James Ross Macdonald, IV
Emily S. McMahon

Functional Tax Reform
Peter v. Z. Cobb
Deborah L. Paul

Individuals
Sherry S. Kraus
Lisa A. Levy

Multistate Tax Issues
Robert E. Brown
Paul R. Comeau

New York City Taxes
Robert J. Levinsohn
William B. Randolph

New York State Franchise and Income Taxes
Marta T. Jones
Arthur H. Rosen

New York State Sales and Misc.
John P. Dugan
Hollis L. Hyman

Partnerships
William E. Brennan
Patrick C. Gallagher

Pass-Through Entities
Kimberly S. Blanchard
Marc L. Silberberg

Real Property
Lay S. Wolf
Alan J. Terr

Reorganizations
Ed J. Schwartz
Eric Solomon

Tax Accounting and Character
Dickson G. Brown
Linda Zan Swartz

Tax Exempt Bonds
Michael Hefens
Linda L. D'Onofrio

Tax Exempt Entities
Michelle P. Scott
Stuart L. Rosow

Tax Policy
David H. Brockway
Kathleen Fernald

U.S. Activities of Foreign Taxpayers
Paul H. Shearing
David P. Harton

MEMBERS-AT-LARGE OF EXECUTIVE COMMITTEE:

M. Carr Ferguson
Kenneth H. Hedner
Thomas A. Humphreys

Sherwin Kamin
Charles I. Kingdon
Glen A. Kohl

Janet Beth Korins
Charles M. Morgan, III
Dale L. Ponikvar

Yaron Z. Reich
Howard J. Rothman
David M. Schizer

Robert T. Smith
Eugene L. Vogel
David E. Watts

July 8, 1999

Re: Relief to Joint Return Filers (Senate Bill No. S05908)

Hon. Sheldon Silver
Speaker
New York State Assembly
State Capitol
Albany, NY 12248

Dear Speaker Silver:

The Tax Section of the New York State Bar Association strongly supports the amendment to subsection (c) of Section 651 of the Tax Law (Senate Bill No. S05908) now being considered by the New York State Legislature. This amendment would add a new paragraph "seven" which would incorporate by reference the recently enacted changes to the innocent spouse relief provisions of the Internal Revenue Code. The Tax Section also supports the repeal of paragraph (5) of subsection (b) of Section 651 of the New York State Tax Law. The bases of these recommendations are set forth below.

The IRS Restructuring and Reform Act of 1998 contained legislation that expanded the relief previously available to those individuals who file federal joint income tax returns. These relief provisions address the obligations of joint and several tax liability that accompany the privilege of filing a joint return; these obligations can place unfair and unanticipated burdens on "innocent spouses".

The federal legislation created a new Section 6015 of the Internal Revenue Code which expanded the circumstances under which "innocent spouse" relief would be available. New Section 6015(b) incorporates the previous innocent spouse rules of former Section 6013(e)

FORMER CHAIRS OF SECTION:

Howard O. Colgan, Jr.
Charles L. Kades
Samuel Brodsky
Thomas C. Flouwen-Wardlaw
Edwin M. Jones
Hon. Hugh R. Jones
Peter Miller

John W. Fager
John E. Montasey, Jr.
Charles E. Herring
Ralph G. Winger
Marlin D. Ginsburg
Peter L. Feber
Hon. Renato Beghe

Allred D. Youngwood
Gordon D. Henderson
David Sachs
J. Roger Mentz
Wilbur S. Taylor
Richard J. Hegel
Dale S. Collinson

Richard G. Cohen
Donald Schapiro
Herbert L. Camp
William L. Burke
Arthur A. Feder
James M. Peaslee
John A. Corry

Peter C. Canellos
Michael L. Schler
Carolyn Joy Lee
Richard L. Reinhold
Richard O. Loengard
Steven C. Todrys

Do the Public Good • Volunteer for Pro Bono

and relaxes somewhat the requirements for relief. Under this provision, a spouse who has joined in the filing of a joint return and is facing deficiency adjustments attributable to erroneous items of the other spouse can obtain relief from joint and several liability, so long as it can be established that, in signing the return, he or she did not know, or have reason to know, of the understatement. For relief under Section 6015(b), there is no requirement that the spouses be divorced, separated or living apart.

The most significant part of the federal legislation, however, was to add a new mechanism for relief by introducing the concept of a "separation of liability election" under new Section 6015(c). For taxpayers who are divorced, separated or living apart, an electing taxpayer can limit his or her liability for any deficiency assessment arising from the joint return to the portion of the deficiency which is separately allocable to that taxpayer, i.e., determined as if a separate return has been filed. This election must be made within two years after collection action is commenced by the Internal Revenue Service.

The federal legislation also introduced another new provision (Section 6015(f)) which grants the Internal Revenue Service the power to relieve the taxpayer from joint and several liability if it is inequitable to hold the taxpayer liable for the tax or any deficiency in tax. For this relief to be available, however, the taxpayer must not be entitled to relief under either the "innocent spouse" rule (section 6015(b)) or the "separation of liability election" (Section 6015(c)). The full extent of equitable relief under this provision will not be known until regulations have been issued by the Department of Treasury.

These changes to the federal innocent spouse statute are generally viewed as significantly expanding relief in appropriate cases to joint return tax filers from the consequences of joint and several tax liability. However, with the exception of some relief possible under the "equitable relief" provisions, all relief under Section 6015 is limited to deficiency assessments and does not extend to self-assessments of tax made on originally filed returns (an issue that arises when insufficient tax accompanies a correct return).¹

The question of extending relief to self-assessments of tax on originally filed joint returns was debated extensively in Congress. It was ultimately concluded that the case for granting relief from joint and several tax liability for the tax shown on an originally filed return was not as strong as the case for relief from deficiency tax assessments. On an originally filed joint return, each spouse has an opportunity and an obligation to review the tax return for its content. The spouse is also on notice of the joint tax liability owed. After having obtained the benefits of rate reduction and simplicity from the filing of a joint return, a party to a joint filing should not later be permitted to disavow the obligation of a joint and several tax liability except in the most inequitable of circumstances. Accordingly, it was concluded that relief under Section 6015 from joint and several liability for the tax shown on an originally filed joint return would be limited to the "equitable relief" provision. While other relief mechanisms continue to be available at the

(continued...)

In 1998, New York undertook its own legislative effort to provide relief to joint return filers from the rule of joint and several liability. While New York has historically had its own "innocent spouse" statute (which followed almost verbatim the federal statute), the 1998 changes were crafted much more broadly. Effective for tax years beginning on or after January 1, 1999, new paragraph 5 of subsection (b) of Section 651 of the Tax Law provides that for joint return filers, "the liability for tax with respect to each spouse will be determined by multiplying the total liability arising from the joint return by a fraction, the numerator of which is the tax for the taxable year at issue determined separately for the taxpayer and the denominator of which is the sum of the taxes for each taxable year determined separately for the spouse and for the taxpayer." Thus, under the new law, the filing of a New York joint tax return by spouses will no longer result in joint and several liability for the tax shown on the return. There is a limited exception that would impose joint and several liability in the event of a deficiency adjustment on the joint tax return for a "substantial understatement of tax attributable to a grossly erroneous item of one spouse." Even in that instance, however, if collection is to proceed against a spouse other than the spouse to whom the erroneous item is attributed, the Commissioner has the burden of proving that the other spouse either knew or had reason to know of the substantial understatement.

The New York State Department of Taxation and Finance has raised a number of concerns regarding this law. The Department believes that it will need to redesign the joint return tax forms quite extensively to require an allocation of all income, deduction and credit between the spouses in order to determine the separate share of tax liability allocable to each of joint filers for collection purposes. Under this redesign, every married couple will have to make three separate calculations of their tax liability: the husband's, the wife's, and the joint, to provide for these multiple calculations on the redesigned tax form. We agree with the Department's concern that introducing this level of complexity for every New York joint tax return filed, solely to determine the share of tax liability attributable to each spouse in the relatively small number of instances where an allocation of liability will ever be an issue², imposes an unnecessary burden (i) on the taxpayers of New York State in having to make this

(...continued)

federal level for all tax liabilities, including those created by originally filed joint returns, taxpayers will not be able to evoke the "innocent spouse" and "separation of liability election" relief provisions of new Section 6015 of the Code to defeat collection of the balance due on the tax shown on an originally filed joint return.

² According to the New York State Department of Taxation and Finance, there are over 3 million joint return filers in New York, but only about 1,000 individuals requesting innocent spouse relief each year.

allocation and (ii) on the Department in receiving and processing this information. Furthermore, even if the allocations are obtained at the time of filing, such does not guarantee that the allocations will be accurate or that the allocation will not later be challenged by the taxpayer or the Department.

We also agree with the Department's conclusion that the legislation creates an unnecessary disparity with federal law, and that relief to joint return filers is best addressed by (i) repeal of N. Y. Tax Law Section 651(5)(b) and (ii) incorporation by reference of the federal innocent spouse statute (IRC Section 6015). In making this recommendation, however, we wish to emphasize that the federal innocent spouse statute does differ in several significant respects from the legislation passed by New York in 1998. First and foremost, under both "innocent spouse" and "separation of liability election", relief extends only to deficiency assessments to the joint tax return and does not extend relief to joint filers for unpaid taxes on an originally filed return except possibly under the "equitable relief" provision. Secondly, the "separation of liability election" is available at the federal level only to joint filers who are divorced, separated or living apart. This is not the case with Section 651(5)(b) of the N. Y. Tax Law.

This does not mean, however, that relief is not available to a joint return filer for self-assessed tax liabilities on an originally filed return. In addition to equitable relief possible under Section 6015(f), the federal innocent spouse statute, relief can be obtained on a case by case basis through mechanisms such as (a) disavowal of the return if the spouse's signature is forged (without consent) or coerced under duress or (b) the Offer in Compromise process. As to the latter, it should be noted that New York State recently added new subdivision eighteenth-d to Section 171 of the Tax Law to grant authority to the Department of Taxation to compromise joint return liabilities of taxpayers who are divorced, separated or living apart from their spouse. The "Offer" amount limits the spouse's liability to his or her allocable share of the joint return liability, if it can be shown that collection of the entire liability can not be accomplished by the Department within a reasonable period of time without imposing substantial economical hardship on the spouse seeking relief.

Hon. Sheldon Silver

-5-

July 8, 1999

The Tax Section of the New York State Bar Association, therefore, strongly urges the Assembly to pass the pending S05908 to obviate the extreme inconvenience that the existing law will impose on every married couple in the state.

Very truly yours,

A handwritten signature in black ink, appearing to read "Harold R. Handler", written in a cursive style.

Harold R. Handler
Chair

cc: Gov. George E. Pataki
James McGuire, Esq.
Hon. Joseph L. Bruno
Hon. Herman D. Farrell
Hon. Arthur J. Roth