§ 1.66–4 Request for relief from the Federal income tax liability resulting from the operation of community property law.

(a) Traditional relief—

(1) In general. A requesting spouse will receive relief from the Federal income tax liability resulting from the operation of community property law for an item of community income if—

(i) The requesting spouse did not file a joint Federal income tax return for the taxable year for which he or she seeks relief;

(ii) The requesting spouse did not include in gross income for the taxable year an item of community income properly includible therein, which, under the rules contained in section 870(a), would be treated as the income of the nonrequesting spouse;

(iii) The requesting spouse establishes that he or she did not know of, and had no reason to know of, the item of community income; and

(iv) Taking into account all of the facts and circumstances, it is inequitable to include the item of community income in the requesting spouse’s individual gross income.

(2) Knowledge or reason to know. (i) A requesting spouse had knowledge or reason to know of an item of community income if he or she either actually knew of the item of community income, or if a reasonable person in similar circumstances would have known of the item of community income. All of the facts and circumstances are considered in determining whether a requesting spouse had reason to know of an item of community income. The relevant facts and circumstances include, but are not limited to, the nature of the item of community income, the amount of the item of community income relative to other income items, the couple’s financial situation, the requesting spouse’s educational background and business experience, and whether the item of community income was reflected on prior years’ returns (e.g., investment income omitted that was regularly reported on prior years’ returns).

(ii) If the requesting spouse is aware of the source of community income or the income-producing activity, but is unaware of the specific amount of the nonrequesting spouse’s community income, the requesting spouse is considered to have knowledge or reason to know of the item of community income. The requesting spouse’s lack of knowledge of the specific amount of community income does not provide a basis for relief under this section.

(3) Inequitable. All of the facts and circumstances are considered in determining whether it is inequitable to hold a requesting spouse liable for a deficiency attributable to an item of community income. One relevant factor for this purpose is whether the requesting spouse benefitted, directly or indirectly, from the omitted item of community income. A benefit includes normal support, but does not include de minimis amounts. Evidence of direct or indirect benefit may consist of transfers of property or rights to property, including transfers received several years after the filing of the return. Thus, for example, if a requesting spouse receives from the nonrequesting spouse property (including life insurance proceeds) that is traceable to items of community income attributable to the nonrequesting spouse, the requesting spouse will have benefitted from those items of community income. Other factors may include, if the situation warrants, desertion, divorce or separation. Factors relevant to whether it would be inequitable to hold a requesting spouse liable, more specifically described under the applicable administrative procedure issued under section 66(c) (Revenue Procedure 2000–15 (2000–1 C.B. 447) (See §601.601(d)(2) of this chapter), or other applicable guidance published by the Secretary), are to be considered in making a determination under this paragraph.

(b) Equitable relief. Equitable relief may be available when the four requirements of paragraph (a)(1) of this section are not satisfied, but it would be inequitable to hold the requesting spouse liable for the unpaid tax or deficiency. Factors relevant to whether it would be inequitable to hold a requesting spouse liable, more specifically described under the applicable administrative procedure issued under section 66(c) (Revenue Procedure 2000–15 (2000–1 C.B. 447), or other applicable guidance published by the Secretary), are to be
considered in making a determination under this paragraph.

(c) Applicability. Traditional relief under paragraph (a) of this section applies only to deficiencies arising out of items of omitted income. Equitable relief under paragraph (b) of this section applies to any deficiency or any unpaid tax (or any portion of either). Equitable relief is available only for the portion of liabilities that were unpaid as of July 22, 1998, and for liabilities that arise after July 22, 1998.

(d) Effect of relief. When the requesting spouse qualifies for relief under paragraph (a) or (b) of this section, the IRS must assess any deficiency of the nonrequesting spouse arising from the granting of relief to the requesting spouse in accordance with section 6212.

(e) Examples. The following examples illustrate the rules of this section:

Example 1. Item-by-item approach. H and W are married, living together, and domiciled in State A (a community property state). H and W file separate returns for taxable year 2002 on April 15, 2003. H earns $56,000 in wages, and W earns $46,000 in wages, in 2002. H reports half of his wage income as shown on his Form W-2, in the amount of $28,000, and half of W's wage income as shown on her Form W-2, in the amount of $23,000. H reports half of her wage income as shown on her W-2, in the amount of $23,000, and half of W's wage income as shown on her Form W-2, in the amount of $23,000. Neither H nor W reports W's income from her sole proprietorship of $34,000 or W's investment income of $5,000 for taxable year 2002. The Internal Revenue Service (IRS) proposes deficiencies with respect to W's additional income, for which H obtained relief under section 66(c). W is liable for the tax on half of H's wage income in the amount of $28,000, half of W's wage income in the amount of $23,000, half of W's sole proprietorship income in the amount of $28,000, and all of W's investment income in the amount of $5,000, because H obtained relief under section 66(c).

Example 2. Benefit. H and W are married, living together, and domiciled in State B (a community property state). Neither H nor W files a return for taxable year 2000. H earns $60,000 in 2000, which he deposits in a joint account. H and W pay the mortgage payment, household bills, and other family expenses out of the joint account. W earns $20,000 in 2000. W uses a portion of the $20,000 to make monthly loan payments on the family cars, but loses the remainder at the local racetrack. In 2002, the IRS audits H and W. H requests relief under section 66(c), stating that he did not know or have reason to know of W's additional income, as H travels extensively while W handles the family finances. Regardless of whether H had knowledge or reason to know of the source of W's income, H is not eligible for traditional relief under section 66(c) because H benefitted from W's income. H's benefit, the portion of W's income used to make monthly payments on the car loans, was more than a de minimis amount. While this benefit was not in excess of normal support, it is enough to preclude relief under the traditional relief provision of section 66(c). H may still qualify for equitable relief under section 66(c), depending on all of the facts and circumstances.

(f) Fraudulent scheme. If the Secretary establishes that a spouse transferred assets to his or her spouse as part of a fraudulent scheme, relief is not available under this section. For purposes of this section, a fraudulent scheme includes a scheme to defraud the Secretary or another third party, such as a creditor, ex-spouse, or business partner.

(g) Definitions—(1) Requesting spouse. A requesting spouse is an individual who does not file a joint Federal income tax return with the nonrequesting spouse for the taxable year in question, and who requests relief from the Federal income tax liability resulting from the operation of community property law under this section for the portion of the liability arising from his or her share of community income for such taxable year.

(2) Nonrequesting spouse. A nonrequesting spouse is the individual to
whom the requesting spouse was married and whose income or deduction gave rise to the tax liability from which the requesting spouse seeks relief in whole or in part.

(h) Effect of prior closing agreement or offer in compromise. A requesting spouse is not entitled to relief from the Federal income tax liability resulting from the operation of community property law under section 66 for any taxable year for which the requesting spouse has entered into a closing agreement (other than an agreement pursuant to section 6224(c) relating to partnership items) with the Secretary that disposes of the same liability that is the subject of the request for relief. In addition, a requesting spouse is not entitled to relief from the Federal income tax liability resulting from the operation of community property law under section 66 for any taxable year for which the requesting spouse has entered into an offer in compromise with the Secretary. For rules relating to the effect of closing agreements and offers in compromise, see sections 7121 and 7122, and the regulations thereunder.

(i) [Reserved]

(j) Time and manner for requesting relief—(1) Requesting relief. To request relief from the Federal income tax liability resulting from the operation of community property law under this section, a requesting spouse must file, within the time period prescribed in paragraph (j)(2) of this section, Form 8857, "Request for Innocent Spouse Relief" (or other specified form), or other written request, signed under penalties of perjury, stating why relief is appropriate. The requesting spouse must include the nonrequesting spouse’s name and taxpayer identification number in the written request. The requesting spouse must also comply with the Secretary's reasonable requests for information that will assist the Secretary in identifying and locating the nonrequesting spouse.

(2) Time period for filing a request for relief—(i) Traditional relief. The earliest time for submitting a request for relief from the Federal income tax liability resulting from the operation of community property law under paragraph (a) of this section, for an amount underreported on, or omitted from, the requesting spouse's separate return, is the date the requesting spouse receives notification of an audit or a letter or notice from the IRS stating that there may be an outstanding liability with regard to that year (as described in paragraph (j)(2)(iii) of this section). The latest time for requesting relief under paragraph (a) of this section is 6 months before the expiration of the period of limitations on assessment, including extensions, against the nonrequesting spouse for the taxable year that is the subject of the request for relief, unless the examination of the requesting spouse’s return commences during that 6-month period. If the examination of the requesting spouse’s return commences during that 6-month period, the latest time for requesting relief under paragraph (a) of this section is 30 days after the commencement of the examination.

(ii) Equitable relief. The earliest time for submitting a request for relief from the Federal income tax liability resulting from the operation of community property law under paragraph (b) of this section is the date the requesting spouse receives notification of an audit or a letter or notice from the IRS stating that there may be an outstanding liability with regard to that year (as described in paragraph (j)(2)(iii) of this section). A request for equitable relief from the Federal income tax liability resulting from the operation of community property law under paragraph (b) of this section for a liability that is properly reported but unpaid is properly submitted with the requesting spouse’s individual Federal income tax return, or after the requesting spouse’s individual Federal income tax return is filed.

(iii) Premature requests for relief. The Secretary will not consider a premature request for relief under this section. The notices or letters referenced in this paragraph (j)(2) do not include notices issued pursuant to section 6223 relating to TEFRA partnership proceedings. These notices or letters include notices of computational adjustment to a partner or partner's spouse (Notice of Income Tax Examination Changes) that reflect a computation of the liability attributable to
partnership items of the partner or the partner’s spouse.

(k) Nonrequesting spouse’s notice and opportunity to participate in administrative proceedings—(1) In general. When the Secretary receives a request for relief from the Federal income tax liability resulting from the operation of community property law under this section, the Secretary must send a notice to the nonrequesting spouse’s last known address that informs the nonrequesting spouse of the requesting spouse’s request for relief. The notice must provide the nonrequesting spouse with an opportunity to submit any information for consideration in determining whether to grant the requesting spouse relief from the Federal income tax liability resulting from the operation of community property law. The Secretary will share with each spouse the information submitted by the other spouse, unless the Secretary determines that the sharing of this information will impair tax administration.

(2) Information submitted. The Secretary will consider all of the information (as relevant to the particular relief provision) that the nonrequesting spouse submits in determining whether to grant relief from the Federal income tax liability resulting from the operation of community property law under this section.

[T.D. 9074, 68 FR 41070, July 10, 2003]

§ 1.66–5 Effective date.

Sections 1.66–1 through 1.66–4 are applicable on July 10, 2003. In addition, §1.66–4 applies to any request for relief filed prior to July 10, 2003, for which the Internal Revenue Service has not issued a preliminary determination as of July 10, 2003.

[T.D. 9074, 68 FR 41070, July 10, 2003]

§ 1.67–1T 2-percent floor on miscellaneous itemized deductions (temporary).

(a) Type of expenses subject to the floor—(1) In general. With respect to individuals, section 67 disallows deductions for miscellaneous itemized deductions (as defined in paragraph (b) of this section) in computing taxable income (i.e., so-called “below-the-line” deductions) to the extent that such otherwise allowable deductions do not exceed 2 percent of the individual’s adjusted gross income (as defined in section 62 and the regulations thereunder). Examples of expenses that, if otherwise deductible, are subject to the 2-percent floor include but are not limited to—

(i) Unreimbursed employee expenses, such as expenses for transportation, travel fares and lodging while away from home, business meals and entertainment, continuing education courses, subscriptions to professional journals, union or professional dues, professional uniforms, job hunting, and the business use of the employee’s home.

(ii) Expenses for the production or collection of income for which a deduction is otherwise allowable under section 212 (1) and (2), such as investment advisory fees, subscriptions to investment advisory publications, certain attorneys’ fees, and the cost of safe deposit boxes.

(iii) Expenses for the determination of any tax for which a deduction is otherwise allowable under section 212(3), such as tax counsel fees and appraisal fees, and

(iv) Expenses for an activity for which a deduction is otherwise allowable under section 183.

See section 62 with respect to deductions that are allowable in computing adjusted gross income (i.e., so-called “above-the-line” deductions).

(2) Other limitations. Except as otherwise provided in paragraph (d) of this section, to the extent that any limitation or restriction is placed on the amount of a miscellaneous itemized deduction, that limitation shall apply prior to the application of the 2-percent floor. For example, in the case of an expense for food or beverages, only 80 percent of which is allowable as a deduction because of the limitations provided in section 274(n), the otherwise deductible 80 percent of the expense is treated as a miscellaneous itemized deduction and is subject to the 2-percent limitation of section 67.

(b) Definition of miscellaneous itemized deductions. For purposes of this section,