# To File Jointly or Not to File Jointly? That Is the Question

**By Jonathan Hoffman**
**And Lynne Z. Gold-Bikin**

Married parties are often able to enjoy the significant benefits of filing a joint tax return during their marriage and potentially during their separation as well. These joint tax returns, while financially beneficial from a tax perspective, may lead to significant problems once litigation ensues.

While there are often many complicated tax issues in a divorce matter, one issue that is commonly faced is a decision as to whether or not separated spouses should continue to file joint returns until the divorce is finalized.

Clearly, putting the parties in a higher tax bracket for no reason makes no sense if it can be avoided. Additionally, for a dependent spouse receiving potentially taxable income (alimony *pendent lite* or spousal support, for example), a joint return can be beneficial if he or she will have no taxes to pay. When then does a joint return become problematic?

### When to Be Wary

There are a few situations in which one spouse should be circumspect. For example, when the self-employed spouse does not report all income received, when the W-2 wage earner also does "side jobs" or when one spouse takes aggressive and/or inappropriate deductions, the other spouse should not be signing a joint return so easily. In addition, when one spouse has always controlled the finances throughout a marriage, and that spouse has been signing the other spouse's name or the tax return is offered to the non-preparing spouse as a signature line on April 14, with no opportunity or copy to review, the practitioner's suspicions must be heightened.

### When You Are Going to Sign

Assuming that a decision is ultimately made by the parties to file a joint tax return, the Internal Revenue Code at section 6013 indicates that each party may be joint and severally liable for any deficiency, liability, interest or penalty related to the filing. This ability of the IRS to assess one spouse or both spouses with liability in varying degrees is essentially the exchange for the often valuable consideration of filing a joint return. It is also a mechanism to ensure that the government gets its money, one way or another.

This concept of joint and several liability will potentially be assessed regardless of the fact that one spouse may prepare and file a return while the other spouse has only limited knowledge regarding the contents of the return. The only exception to the joint and several liability is contained in the "injured and innocent spouse" provision section 6015 of the Code. This provision may serve to protect one spouse from the potential liability arising from the misstatements or under reporting of income on the filing of a joint return.

### An 'Innocent and Injured Spouse'

Prior to 1998, it was extremely difficult for an "innocent and injured spouse" to get relief. This burden was lightened in 1998 with the passing of the Restructuring and Reform Act (RRA) of 1998. The RRA allows an "injured and innocent spouse" various forms of relief, all of which can be sought simultaneously. Under section 6015 of the Code, if a spouse is married and seeking relief from a joint return, he or she would need to meet the following requirements to gain relief:

- A joint return has been made for a taxable year;
- In such return, there is an understatement of tax attributable to erroneous items of one individual filing the joint return;
- The other individual filing the joint return establishes that, in signing the return, he or she did not know, and had no reason to know, that there was such understatement;
- Taking into account all the facts and circumstances, it is inequitable to hold the other individual liable for the deficiency in tax for such taxable year attributable to such understatement; and
- The other individual elects (in such form as the Secretary may prescribe) the benefits of this subsection not later than the date that is two years after the date the Secretary has begun collection activities with respect to the individual making the election.

Assuming the above qualifications are met by the spouse seeking relief, he or she will be relieved of liability for that tax year to the extent that such liability is attributable to such understatement. In addition, the relief for the spouse is limited to any such liability attributable to the understatement of which the spouse did not or could not have had knowledge.

If a spouse seeking relief is no longer married at the time of the filing of an election for relief or was not a member of the same household as the other spouse for a period of 12 months ending on the date that the election is filed, the spouse or former spouse may seek protection under an additional section of the Code. It is essential that a spouse seeking protection from liability on a joint return files the election for relief within two years after the date that the Service has begun collection activity on the electing spouse. If an election is successfully filed, the filing spouse will not be responsible for any deficiency on the return that is not properly allocated to him/her.

*continued on page 4*

**Lynne Z. Gold-Bikin**, a member of this newsletter's Board of Editors, is a partner in Weber Gallagher's Family Law practice group, which she chairs. Prior to joining Weber Gallagher, Ms. Gold-Bikin was a partner and chair of the Family Law Practice Group at WolfBlock LLP. **Jonathan Hoffman** is an associate at the firm.

## *Joint Filing*

*continued from page 3*

**Fraudulent Activity**

While an election that meets either of the above qualifications will result in at least partial indemnification for an "injured and innocent spouse," fraudulent activity or actual knowledge of erroneous filings on the part of the spouse seeking relief will negate any opportunity that he or she had to claim status as an "injured and innocent spouse."

The Service has maintained that spouses electing for relief must make an election with clean hands or they, too, will be subject to liability, fees, interest, penalties and perhaps sanctions. A spouse filing such tax returns cannot have knowledge or awareness of under reporting and then claim innocence once the Service assesses a deficiency. In other words, a husband or wife may not enjoy the benefits of all of the income and suddenly try to claim "innocent and injured spouse." It is only where the one with the money is putting it in a separate pocket and it is not being spent during the marriage that "innocent and injured spouse" can even arise.

**Conclusion**

The issue of a joint filing is a complicated one — and one that is usually not within the expertise of a divorce lawyer. Tax advice should be sought from an accountant who has the expertise to know the Tax Code and all its regulations and give the appropriate advice on the filing. Often, the prudent attorney will suggest that the parties sign a tax indemnification agreement, supposedly to alleviate this exposure to the spouse whose income is not in question. However, an indemnification letter is effective only with regard to acts between husband and wife. Consequently, where the husband agrees to indemnify the wife, in the event the IRS reviews the return and assesses penalties, the wife is not protected from liability but must assert her claims against the husband. From the government perspective, the wife will still be responsible for potential taxes, interest, penalties and legal fees. She will then have to sue the husband to reimburse her for any taxes, interest, penalties and legal fees that she has been required to pay. As this article points out, tax issues are beyond the expertise of most matrimonial attorneys. The accountants and their advice really become essential in these cases.

## *IP Assets*

*continued from page 2*

time of the commencement of the divorce action. The court considered the book deal and stated that "[t]he book contract and payments thereunder are assets," but it ultimately did not give the Supporting Spouse an interest in it, given the couple's considerable wealth. *But see Michel v. Michel*, 484 So.2d 829 (La. Ct. App. 1986) (awarding Supporting Spouse a share of the profits from the Creative Spouse's book deal, even though the book in question was only in outline form at the time of commencement).

When faced with this kind of scenario, a good framework for determining how much a Supporting Spouse should receive is to use the formula some courts use in a divorce for the division of stock options. *See, e.g., DeJesus v. DeJesus*, 90 N.Y.2d 643, 687 N.E.2d 1319, 665 N.Y.S.2d 36 (1997). As with unexercised stock options, here there is an agreement for potential future income that was entered during the marriage, but will not generate income until post-judgment, income that is contingent on the Creative Spouse's post-commencement efforts. This stock option formula divides the amount of time from the contracting date to the date of commencement by the total time from the contract date to the date of the receipt of benefits under the contract. Applying this formula would give a Supporting Spouse a percentage of future income steams in the Creative Asset equivalent to the percentage of time that the contract existed during the marriage. To arrive at the "total time" denominator in the above formula, attorneys should look to the projected times estimated in the third-party agreement for the Creative Asset to be complete. Also, the Creative Spouse's attorney should always ensure that the Supporting Spouse's interest does not trigger before the third party has fully recouped its advances.

**Dividing the Creative Asset When There Is No Market-Defined Value**

Even where no third party has demonstrated an interest in the Creative Asset and any future income or value from the Creative Asset is contingent on myriad factors, including luck, the Supporting Spouse may still be entitled to a share of the Creative Asset.

There is a body of case law that suggests that in this scenario, the correct result is to allot the Supporting Spouse a percentage of any future benefit that may be realized, if, as and when the Creative Spouse receives such benefit. In *Gulbrandsen v. Gulbrandsen*, 22 So.3d 640 (Fla. Dist. Ct. App. 2009), where the Creative Spouse had co-developed a device with a pending patent application, instead of attempting to obtain a share of the device's future value based on estimates or based on the time and expense put into its development, the Supporting Spouse argued for an in-kind share. The court awarded the Supporting Spouse 12.5% of any future benefits from the patent, if any were ever realized. Other courts have made similar percentage distributions of intellectual property assets that have yet to be exploited. *See, e.g., In re Marriage of Monslow*, 259 Kan. 412, 912 P.2d 735 (Kan. 1996).

There is, however, a countervailing body of case law that suggests that where there is no readily ascertainable value to a Creative Asset, it is too speculative to divide. In *VanWormer v. VanWormer*, No. 186493,

*continued on page 8*