

**Office of Chief Counsel
Internal Revenue Service
*memorandum***

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from: Charles A. Hall
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subject: Allocation of Overpayments in Innocent Spouse Cases – Earned Income Credit (EIC)

This program manager technical assistance memorandum supplements the advice we gave to Janet Boatright last year respecting how joint overpayments and refunds are to be handled in innocent spouse cases when the first-time homebuyer credit (FTHBC) is involved.

ISSUE

Whether a requesting spouse (RS) is considered to have provided funds for a joint overpayment, when the joint overpayment arises at least in part from the EIC and the Service applies such overpayment to the joint income tax liability of another taxable year for which RS is later determined to be eligible for relief from joint and several liability under section 6015.

CONCLUSION

Yes, as calculated under the guidelines described below, a RS will be considered to have provided funds for a joint overpayment that arises, at least in part, from the EIC.

FACTS

Notice 2012-8, 2012-1 C.B. 309, states in part, “. . . [a] requesting spouse . . . may be eligible for a refund of the requesting spouse’s portion of the requesting and nonrequesting spouse’s joint overpayment from another tax year that was applied to the joint income tax liability to the extent that the requesting spouse can establish that the requesting spouse provided the funds for the overpayment.” Below we provide assistance in determining how joint overpayments should be treated when the EIC is the source of all or a part of a joint overpayment that is offset against the joint tax liability of another taxable year for which a RS is later determined to be eligible for

innocent spouse relief.

DISCUSSION

The innocent spouse provisions of the Code do not provide guidance on how to treat credits and overpayments when the Service has offset under section 6402(a) a joint overpayment that arises at least in part from the EIC from another tax year to outstanding joint tax liability for a taxable year for which a RS is later determined to be eligible for innocent spouse relief. A RS who qualifies for innocent spouse relief in this situation is analogous to a taxpayer commonly described as an “injured spouse” who seeks a return of funds which the Service applied to satisfy the tax liability of another. It is necessary to look to guidance from other areas, apart from the published guidance under section 6015, to determine whether a RS will be entitled to a refund as a result of obtaining innocent spouse relief.¹

Rev. Rul. 87-52, 1987-1 C.B. 347 provides a method for allocating an EIC shown on a joint return to determine the amount of a joint overpayment that can be applied to the separate tax liability of one spouse pursuant to section 6402(a). Rev. Rul. 87-52 determines each spouse’s contribution to the credit by multiplying the joint EIC by the ratio of each spouse’s hypothetical separate EIC to the sum of hypothetical separate EICs for both spouses.² The separate credit is hypothetical because the EIC is not available on separate returns of married individuals. I.R.C. § 32(d).³

The allocated amount of each spouse’s share of the EIC under Rev. Rul. 87-52 is based on the hypothetical separate EIC that would have been available to each spouse if that person filed a separate return (if the EIC were available on a separate return) using the EIC Table, and then applying the following formula:

¹ A RS bears the burden of establishing entitlement to a refund, based on eligibility for innocent spouse relief under section 6015(b) or (f). This includes establishing the portion of the overpayment, including any portion due to the EIC, for which the RS will be considered to have provided the funds under the revenue rulings mentioned in this memorandum and the parts of the Internal Revenue Manual dealing with the allocation of joint items in injured spouse cases.

The payment of a refund to a RS eligible for innocent spouse relief is subject to the condition in section 6511 that the claim must be made within 2 years of the date of offset, or 3 years of the date of the filing of the return, whichever of these periods expires later.

² Section 32(b) phases out the amount allowable as an EIC based on the taxpayer’s number of qualifying children. For a couple filing a joint return, the amount of the allowable EIC may be less than the aggregate credits that would be allowable if each spouse’s EIC were to be considered separately (assuming the EIC were available to married taxpayers who file separate returns). Consequently, the EIC could not be allocated on a dollar-for-dollar basis by merely recomputing the credit based on taxpayers filing separately.

³ Section 32(c)(2)(B)(i) provides that “earned income” is computed without regard to any community property laws. As a result, the formula expressed below for determining a spouse’s share of the EIC is valid for taxpayers in both community property and common law states, as was true when Rev. Rul. 87-52 was published.

Spouse's contribution = $\frac{\text{spouse's hypothetical separate EIC}}{\text{sum of the hypothetical EICs of both spouses}}$ X joint EIC
to EIC

The method used in Rev. Rul. 87-52 to identify each spouse's share of an EIC for offsetting under section 6402 provides a useful framework for determining the portion of an EIC provided by a RS for purposes of section 6015.

We address whether a RS provided funds for a joint overpayment, arising at least in part from the EIC, which is offset against joint tax liability for another taxable year for which the RS is eligible for relief under section 6015.

Consider the following examples:

Example 1. – EIC Offset against Unpaid Liability for Earlier Tax Year

H and RS are married and have 2 children. For taxable year 2009 they file a joint income tax return which included RS's wages, business income for a sole proprietorship of H, and interest and dividends received from the couple's joint investments. H did not make sufficient estimated tax payments during 2009 and there was a \$2,000 balance due with joint tax return. H assured RS that the tax due with the return would be paid, but it was not. The Service assesses the \$2,000 against H and RS.

For taxable year 2011 H and RS filed a joint income tax return on which they reported joint adjusted gross income totaling \$40,250. This is comprised of H's self-employment income of \$30,000, RS's wages in the amount of \$10,000 and interest and dividend income of \$250. The couple's taxable income after the standard deductions and exemptions was \$13,850. H and RS's joint income tax liability for 2011 was \$1,388.⁴ The couple claimed, and the Service approved the following credits against tax for 2011:

Income tax withheld (from RS's wages):	\$ 500
Estimated Tax Payments:	\$1,000
EIC	<u>\$1,215⁵</u>
Total credits:	\$2,715

The Service's computer system applies the credits to the 2011 liability, which is

⁴ 2011 Form 1040 Instructions, Tax Table, pg. 75 (tax applicable to married filing jointly taxpayers who received taxable income of \$13,850).

⁵ This is the EIC allowable to married individuals with 2 qualifying children receiving at least \$40,250 of earned income but less \$40,300. 2011 Earned Income Credit (EIC) Table, 2011 Form 1040 Instructions, pg. 65.

fully satisfied. The Service then offsets the remaining credit of \$1,327 (2,715 *minus* \$1,388) against the couple's 2009 assessed liability.

In 2012 H and RS are divorced. RS, who was receiving collection notices from the Service for the remaining 2009 tax liability, files a Form 8857 with the Service requesting equitable innocent spouse relief. The Service determines RS is eligible for equitable relief respecting the \$2,000 underpayment for taxable year 2009. In determining whether RS is entitled to a refund of any of the \$1,327 joint refund offset from the year 2011 against the joint liability for taxable year 2009, RS will be deemed to have provided \$772 of the \$1,215 in EIC from taxable year 2011, calculated as follows:

$$\text{H's share} = \frac{\$2,304^6}{\$2,304 + \$4,010} \times \$1,215 = \$443$$

$$\text{RS's share} = \frac{\$4,010^7}{\$2,304 + \$4,010} \times \$1,215 = \$772$$

As for the remaining \$112 of the 2011 joint overpayment that was offset (\$1,327 refund *minus* \$1,215 EIC), that portion comes from H's estimated tax payments and RS's withholding. That portion of the joint overpayment should be allocated based on each spouse's contribution to the joint overpayment under rules similar to those described in Rev. Rul. 80-7, 1980-1 C.B. 296 (for non-community property states).

Example 2. – EIC Offset against Unpaid Liability for Earlier Tax Year- EIC Exceeds Joint Overpayment Amount

Assume the same facts as in *Example 1*, except that part of the EIC is used to satisfy the 2011 joint tax liability because the couple's withholding tax and estimated tax payments are not sufficient to fully pay the 2011 joint income tax liability:

Income tax withheld (from RS's wages):	\$ 500
Estimated Tax Payments:	\$ 800
EIC	<u>\$1,215</u>
Total credits:	\$2,515

The Service's computer system applies the credits to the 2011 liability, which is

⁶ This represents the EIC that would be allowable for taxable year 2011 to a single individual with two qualifying children, (i.e. the hypothetical separate credit described above) who received at least \$30,000 of earned income but less than \$30,050. 2011 Form 1040 Instructions (EIC Table), pg. 62.

⁷ Similarly, this is the EIC that would be allowable for 2011 to a single individual with two qualifying children who received between \$10,000 and \$10,050 of earned income. 2011 Form 1040 Instructions (EIC Table), pg. 55.

fully satisfied. Because the total of the 2011 credits for income tax withheld from RS' wages and estimated tax payments was \$1,300 and the couple's joint 2011 income tax liability was \$1,388, it follows that \$88 of the EIC was used to satisfy the 2011 tax. The Service offsets the remaining credit of \$1,127 (\$2,515 *minus* \$1,388) against the couple's 2009 assessed liability.

In determining whether RS is entitled to a refund of any of the \$1,127 joint overpayment from 2011 offset against the joint liability for 2009, RS will be deemed to have provided \$716 of the remaining part of the 2011 EIC, which is \$1,127 (\$1,215 minus \$88). We recommend calculation of RS's share of the EIC by the same method as in *Example 1*:

$$\text{H's share} = \frac{\$2,304}{\$2,304 + \$4,010} \times \$1,127 = \$411$$

$$\text{RS's share} = \frac{\$4,010}{\$2,304 + \$4,010} \times \$1,127 = \$716$$

Please call Gerald Semasek at (202) 622-4910 if you have any questions.