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ARTICLE: ALLOCATION OF THE JOINT RETURN MARRIAGE PENALTY AND BONUS

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SUMMARY:
... If the same taxpayers are married, their joint return gross income of $ 59,500 results in taxable income of $ 47,950 and a tax of $ 8,356. ... Should the joint tax liability of $ 16,896 be allocated based on the spouses' relative adjusted gross income, relative taxable income or relative tax? ... The court implicitly adopted an allocation method in which the joint tax liability and refund were allocated solely to Mrs. Maragon based on the fact that she was the only spouse with taxable income or separate tax. ... In calculating the separate tax liability of each spouse, one initially should apply the $ 100,000 married filing jointly phase-out limitation and then recalculate based on the joint return adjusted gross income if the combined total is different than the spouses' separate returns. ... The question raised by the phase-outs is whether in calculating each spouse's separate tax, the phase-outs should be made on a joint or separate basis? Although there does not appear to be any authority on this issue, it appears that the most logical method of calculating the separate tax liability of A and B is to use limits as they apply on a separate return basis rather than try to reallocate the joint return limitations. ...

TEXT:
[*489] **[*490]** **[*491]** I. INTRODUCTION

Many articles explore the phenomena of the marriage penalty, a concept where a couple pays a larger tax if they are married than they would if they were unmarried. [n1] On the other hand, a marriage bonus results when a married couple pays less tax than they would if they were unmarried. [n2] Married couples who have relatively equal taxable incomes generally incur a marriage penalty whereas married couples where one spouse earns most of the income generally attain a marriage bonus. [n3] This article does not focus on the existence of the penalty or the bonus which results from filing a joint federal income tax return. Instead, it discusses how a married couple with separate income streams should allocate the penalty or the bonus.

II. MARRIAGE PENALTY AND BONUS -- AN OVERVIEW

A. Marriage Penalty -- Explanation and Example

Dual income couples incur the marriage penalty because they are pushed into tax brackets higher than they would be in if they were not married and filed as single. For example, if each of two single taxpayers reports gross income of $ 29,750 **[*492]** and taxable income of $ 23,350, [n4] the income tax per taxpayer is $ 3,502.50, giving a total tax of $ 7,005 for both taxpayers. If the same taxpayers are married, their joint return gross income of $ 59,500 results in taxable income of $ 47,950 [n5] and a tax of $ 8,356. This hypothetical couple therefore pays income taxes of $ 8,356 if they are married, versus $ 7,005 if they are not married, resulting in a penalty of $ 1,351. [n6]

B. Marriage Bonus -- Explanation and Example

If either spouse earns separate gross income of $ 59,500, then the married couple attains a marriage bonus. Whereas, if the couple was not married, the wage earning taxpayer could file as single with two exemptions. [n7] Single taxable income of **[*493]** $ 50,600 [n8] results in a tax of $ 11,133 and a marriage bonus of $ 2,777. [n9]

C. Taxpayer Stories

A typical marriage penalty story is told by a certified public accountant in which a couple who lived together pretended to get married to appease their families. "Only the Internal Revenue Service and the minister knew they were not really married." [n10] According to the CPA, the first year's tax savings paid for the "non-wedding." [n11] One taxpayer even argues that the imposition of a marriage penalty constitutes "an exercise of government power on the side of immorality." [n12]

D. Incidence and Magnitude of the Penalty and Bonus

One recent study reports that 52 percent of the taxpayers who file a joint return pay a marriage penalty while 38 percent receive a marriage bonus. [n13] According to the study, the average **[*494]** marriage penalty was $ 1,244 and the average marriage bonus was $ 1,399. [n14] If the study is correct, the net effect is a penalty of $ 115.22 for the "average" married couple. [n15] Another article points out that the 1993-94 tax brackets could easily generate a $ 4,500 penalty in the case of a married couple with taxable income of $ 230,000. [n16] In fact, the sale of the family home, a relatively common occurrence, can produce a marriage penalty of $ 35,000. [n17] Another article points out that the elderly face a marriage penalty of more than $ 1,500 based on 1993 tax changes. [n18]

E. Break-Even

What is the break-even point for a married couple as compared to two single taxpayers, if their joint gross income is $ 90,000? If A and B are married, their joint return income tax liability, assuming the standard deduction and two exemptions, is $ 16,896. [n19] If they are not married, they receive a marriage bonus if one spouse earns less than $ 20,800 and they are **[*495]** subject to a marriage penalty if the lower income spouse earns more than $ 20,800. [n20]

F. Should Married Couples Divorce and Single Couples Marry?

If taxes are the only concern for a couple, then individuals should seek tax advice prior to marriage, [n21] and continue to seek tax advice once married. [n22] While New Years Eve divorces with New Year's Day marriages may not work for tax purposes, [n23] genuine divorces can save taxes. [n24] Conversely, many single earner couples should consider marriage as a "tax shelter." Of **[*496]** course, non-tax factors such as alimony also should be considered.

Even a marriage that does not save a couple income taxes may result in savings since it may entitle the non-working spouse to collect social security benefits based on the working spouse's earnings, [n25] or allow either spouse to utilize the unlimited estate tax marital deduction [n26] and the unlimited gift tax deduction. [n27]

Are marriage penalties and bonuses a reason for couples to marry or divorce? [n28] Those questions are better left to the couple, their families, friends and clergy. Some lawyers and accountants may believe that pointing out these problems in newspapers and law review articles will result in legislative solutions; [n29] however, none of the articles has

found a solution that creates a "just" tax system. n30 The marriage penalty and bonus have existed for years, and Congress' attempt to use tax credits to eliminate the marriage penalty has not solved the problem. n31 As one author pointed out: "It seems that the **[*497]** government has found, as have we all, that identifying the problem is much easier than finding the solution." n32

III. ALLOCATION

Because of the marriage penalty and bonus, married taxpayers with separate income streams who file joint federal income tax returns are faced with the problem of allocating the joint tax liability so that each spouse pays his or her share of the joint tax. This article deals only with problems posed in attempting to allocate the joint tax liability to each spouse. n33 It neither attempts to identify the causes of the marriage penalty and bonus n34 nor prescribes solutions, unless doing so helps in understanding the allocation of the joint tax liability, since there are numerous articles which present such evidence and suggest solutions. n35

A. Method of Determining Separate Tax Liability

If each spouse is to pay his or her share of the joint tax liability, then he or she first must determine his or her own separate income and deductions as if he or she were filing separate returns. There are several articles on how to allocate these items, especially in the context of community property. n36 However, there is very little case law in the area of allocating **[*498]** income and deductions in the context of married taxpayers filing separately. This may result from the fact that most separate returns are fairly straightforward: it is either his or her wages or bank account. The identification issue is often simple if the married couple lives separately and does not share income or expenses. The scarce case law may also result from the relatively low number of married couples filing separate returns. In 1993, it is estimated that taxpayers filed 44,072,000 joint returns but only 2,240,000 married filing separate returns. n37

Unlike the limited number of articles and cases relating to allocation of each spouse's separate income and deductions when filing separate returns, there are no articles which discuss how the joint tax liability of a couple should be allocated to each spouse. Case law and articles relating to allocation of the joint return tax liability are lacking probably since such an allocation does not necessarily concern the Service. n38 Similarly, civil cases between spouses are rare since the allocation of the joint tax liability would require one spouse to sue the other spouse for reimbursement or attempt to force one's separated spouse to file a joint return. n39 The lack of case law may also result from the fact that most couples probably do not allocate their taxes, or if they do, the allocation is based on the couple's own concept of fairness or on the advice of their tax professional. However, the lack of authority on how to allocate taxes between spouses filing a joint return does not mean that the taxes should not be allocated.

[*499] *B. Why Allocate?*

There are several situations in which couples filing a joint federal tax return need to allocate their taxes. First, assume that A and B, a married couple, keep all their earnings and expenses separately and file a joint income tax return. In March or April, the "news" is received from their accountant that the couple owes an additional $ 2,000 in taxes. Should one spouse pay the tax debt or should both pay a portion of the $ 2,000? n40 Without allocating their tax liability, it is not possible to answer this question. Similarly, an allocation is also required if a $ 2,000 refund is received.

Moreover, if A and B are married and A dies on July 1st, how should their joint tax liability be shared, assuming that they each earned the same monthly salary and that was their only income? Since the joint return includes all of B's income for the year and only includes A's income through June, how should B and the estate of A share the joint income tax liability for the year? n41 If there is a refund or payment due, only by allocating the joint tax liability can A's estate be settled. The same situation exists in the year of marriage because the separate earnings of each spouse prior to marriage are included on the joint return.

The majority of cases that require allocation involve couples with separate property. This can occur in separate

property states or in community property states if either spouse has separate property. [n42] Since the spouse's income will not be **[*500]** equal when separate property is present, his or her share of the joint tax liability will not be equal and an allocation of the joint liability is required if each spouse is to pay his or her share of the joint debt or receive his or her share of the joint refund.

C. When is it Unnecessary to Allocate Tax Liability?

Couples who share all income and expenses have no reason to allocate their tax liability any more than they have a need to determine who pays the grocery bill or the auto insurance. Since all bank accounts and other assets are jointly owned, allocation is irrelevant until they divorce or until one spouse dies. This is a very common situation in community property states since, in the absence of separate property, each spouse is deemed to own one-half of everything. [n43]

D. When is it Advisable to Allocate Tax Liability?

Couples who live in separate property states and couples who live in community property states and have separate assets should allocate their tax liability. Thus, where a wife's separate property or the community property is used by a husband to pay his property tax liability, there is generally an obligation to repay this "loan." [n44] Failure to do so may indicate an agreement to make a gift of the unallocated taxes [n45] and laches may apply in a subsequent attempt to retroactively seek reimbursement. [n46]

Couples who live in either separate or community property states are required to allocate the joint tax liability in the year in which one spouse dies in order to determine the tax payable **[*501]** by the decedent's estate. [n47] Any refund allocable to the decedent will pass under the decedent's will rather than being refundable to the surviving spouse. If taxes are owed on the joint return, the estate's final tax payment is deductible on the decedent's estate tax return. [n48]

E. Sample Allocation

Assuming that a couple decides to allocate its joint tax liability, how should the allocation be performed if A and B are married, work full time, earn the same salary, take the standard deduction, have no dependents, kept all their finances separately and their lowest possible tax is $ 5,000? Everyone would agree that A and B should pay one-half the tax liability or $ 2,500 each. If the couple's withholding of $ 4,900 results in a liability of $ 100, then the IRS and many A's are satisfied if B "volunteers" to include a check for $ 100 with the tax return. Suppose however that A had $ 2,800 withheld and B had $ 2,100 withheld from their respective wages. If A and B allocate their $ 5,000 tax liability, they would realize that B owes A $ 300 calculated as follows:

	A	B	Total
Tax due:	$ 2,500	$ 2,500	$ 5,000
Less:			
Withholding:	(2,800)	(2,100)	(4,900)
Paid with tax return:	(0)	(100)	(100)
(Due)/Owed to			
each other:	($ 300)	$ 300	None

As the above chart illustrates, even with equal income and deductions, an allocation is usually required since the withholding taxes may not be paid equally. When income is not equal, it is almost certain that an allocation is required, unless one spouse does not mind paying the other's income tax liability.

[*502] *F. Alternative Allocation Methods*

All cases are not as easy as the 50/50 situation described above. Suppose A earns $ 30,000 and B earns $ 60,000.

Should the joint tax liability of $ 16,896 [n49] be allocated based on the spouses' relative adjusted gross income, relative taxable income or relative tax?

If the joint tax liability is allocated based on A and B's relative adjusted gross income, it would be allocated 33% and 66% respectively [n50] and the tax would be allocated as follows:

Taxable Income Allocation -- Using Adjusted Gross Income -- Married Filing Separately Status

	A	B	Joint
Based on AGI, 33.33%/66.67%	$ 5,632	$ 11,264	$ 16,896

If the joint tax liability is allocated based on A and B's relative taxable income (assuming married filing separate status), then it would be allocated 30.88% and 69.12% **[*503]** respectively based on taxable incomes of $ 24,225 and $ 54,225 [n51] and the tax would be allocated as follows:

Taxable Income Allocation -- Using Taxable Income -- Married Filing Separately Status

	A	B	Joint
Based on taxable income, 30.88% / 69.12%	$ 5,217	$ 11,679	$ 16,896

Given the same gross income of $ 30,000 and $ 60,000 respectively, what would happen if the single filing status was used instead of the married filing separate status? Based on the single filing status, the separate taxable incomes of A and B would be $ 23,600 and $ 53,600 and the joint tax liability would be allocated 30.57% and 69.43%, [n52] producing slightly different results from the married filing separately status. The resulting tax allocation would be:

[*504] *Taxable Income Allocation -- Using Taxable income -- Single Status*

	A	B	Joint
Based on taxable income, 30.57% / 69.43%	$ 5,165	$ 11,731	$ 16,896

Another possibility is to allocate the joint tax liability based on each spouse's relative separate tax liability using the married filing separate tax status. Using this method, the married filing separate income taxes of A and B are $ 4,248 and $ 12,861 and the joint tax liability would be allocated 24.83% and 75.17%. [n53] If the separate tax liabilities of A and B are determined using the single filing status, then they have separate tax liabilities of $ 3,573 and $ 11,973, resulting in an allocation ratio of 22.98% and 77.02%. [n54] The resulting tax allocations would be:

[*505] *Tax Liability Allocation -- Income Tax*

	A	B	Joint
Based on Married filing separately, 24.83%/75.17%	$ 4,195	$ 12,701	$ 16,896
Based on Single, 22.98%/77.02%	$ 3,883	$ 13,013	$ 16,896

Under all of the possible allocations listed above, the joint tax liability of $ 16,896 would be allocated as follows:

Tax Liabilities Based on Various Allocation Formulas

Taxpayer	A	B
Gross Income	$ 30,000	$ 60,000
Based on relative AGI	$ 5,632	$ 11,264
Based on relative taxable income (Married filing separately)	$ 5,217	$ 11,697
Based on relative taxable income (Single)	$ 5,165	$ 11,731
Based on relative tax (Married filing separately)	$ 4,195	$ 12,701
Based on relative tax (Single)	$ 3,883	$ 13,013

Based on gross income of $ 30,000 and $ 60,000, there are several possible methods of allocating the married filing joint tax liability of $ 16,896. The alternative methods result in a shift of income tax liability between the spouses of $ 1,749, for A $ 5,632 - $ 3,883 and for B $ 13,013 - $ 11,264.

The combined tax liability of A and B is $ 15,546 if they are single, $ 3,573 and $ 11,973 respectively. [n55] Thus, the above **[*506]** example results in a marriage penalty since the couple's joint tax liability of $ 16,896 is $ 1,350 more than their "single" tax liability of $ 15,546. [n56] Moreover, as different allocation methods are used, the penalty shifts between the spouses. Using the relative AGI or taxable income methods actually results in a tax bonus for B and a huge tax penalty for A. Using relative separate tax liabilities results in both A and B paying a portion of the marriage penalty. In no case does A receive a marriage tax bonus, since A's allocated tax is never reduced to $ 3,573.

IV. DETERMINING THE PROPER ALLOCATION METHOD

Listed above are three methods of allocating the joint income tax liability of a married couple between the spouses. They consist of allocating the joint liability based on relative adjusted gross income, relative taxable income and relative federal income tax. Under the last two methods, a different result is obtained depending on the filing status used to make the separate tax calculations.

The benefits and detriments of each method must be analyzed to determine if one method is the proper method for allocating the couple's joint tax liability. Once a proper method has been determined, the proper filing status for making the tax determinations must also be determined. [n57] Finally, problems in performing separate tax calculations for each spouse must be resolved.

The first issue that must be resolved is the proper method to be used in calculating each spouse's separate tax liability. Should the calculation be based on relative adjusted gross income, taxable income or tax liability?

[*507] *A. Based on Adjusted Gross Income*

Basing an allocation on adjusted gross income ("AGI") is generally an unacceptable method of allocation. AGI does not take into account each spouse's itemized deductions or personal exemptions. Such exemptions almost always result in different ratios than would result if AGI was the basis of allocation. Even in situations where a couple uses the standard deduction [n58] AGI will rarely be an acceptable basis for allocating the joint tax liability since each spouse's income will usually be in a different ratio than if each were given an equal standard deduction and equal personal exemptions.

The major problem with using AGI arises when the couple uses itemized deductions. If A and B each have $

30,000 of separate adjusted gross income and A has itemized deductions of $ 10,000 and B has itemized deductions of $ 5,000, using AGI as the allocation formula would produce an allocation ratio of 50% each. An allocation method based on either taxable income or the separate tax of A and B produces an allocation ratio in which A's share of the joint tax is less than 50%. Since A's itemized deductions are directly responsible for reducing the joint tax liability, and since using AGI fails to take itemized deductions into account, it generally should not be used as a method of allocating the joint tax liability.

Although itemized deductions are directly related to the joint tax liability because they are used to calculate taxable income, [n59] Revenue Ruling 74-486 [n60] states that gross income should be used for allocating state taxes. It states that in determining the proper deduction for state income taxes, a spouse who files a joint state tax return and a separate federal tax return is "entitled to deduct on the Federal return that portion of the total State income taxes imposed and paid during the taxable year which the gross income of each spouse bears to their **[*508]** combined gross income. . . ." [n61] As discussed above, it is hard to justify this conclusion. Clearly, using "gross income" [n62] can not be correct when allocating state taxes in those states in which the tax is based on taxable income, since the tax bears only an indirect relationship to either the gross or even the adjusted gross income of each spouse. The same reasoning leads to the conclusion that using adjusted gross income cannot be the proper basis for allocating a couple's joint tax liability for federal income tax.

B. Based on Taxable Income

Another method of allocating the joint federal tax liability is to use the ratio of each spouse's separate taxable income. Unlike the AGI method, this method has some merit since the joint tax is calculated based on combining A and B's separate taxable incomes. Accordingly, if A's gross income is $ 30,000 and B's is $ 60,000, giving them separate taxable incomes of $ 24,225 and $ 54,225, [n63] the $ 16,896 joint tax liability could logically be allocated based on the ratio of each spouse's respective taxable income. This method, by using taxable income, also takes into consideration each spouse's itemized deductions.

The problem with using taxable income is that this method creates an allocation which causes each spouse to pay tax at the same tax rate. The effect of A and B paying at the same tax rate, regardless of relative income, is to undermine the **[*509]** progressive income tax system. To illustrate the problem, if in the above example A files a separate return, A would report tax of $ 4,248 and thus an average tax rate of $ 17.57%. [n64] B would pay a separate tax of $ 12,861 and thus an average tax rate of 23.72%. [n65] The couple's joint tax liability of $ 16,896 results in an average tax rate of 21.50%. [n66] The result of allocating the joint tax liability based on relative separate taxable incomes is to allocate $ 5,217 of the joint liability to A and $ 11,697 to B. [n67] Accordingly, if the allocation is based on taxable income, A, the lower income taxpayer, will have a marriage penalty of almost 4% and B, the higher income taxpayer, will receive a marriage bonus of almost 2.25%.

The effect of using taxable income as a method of allocating the joint tax liability is to increase the relative tax of the spouse with the lower income and to decrease the relative tax of the higher earner. That does not appear to be either fair or consistent within a progressive tax system. Accordingly, the taxable income method does not appear to be an acceptable method for allocating the joint tax liability.

C. Based on Federal Tax

The final method of allocating the joint federal tax liability is to use the ratio of each spouse's separate tax liability. Use of this method causes the marginal tax rates of each taxpayer to be a factor in determining the allocation. Thus, in the above example, if A and B have $ 30,000 and $ 60,000 of gross income and separate tax liabilities of $ 4,248 and $ 12,861 respectively, [n68] **[*510]** the tax is allocated $ 4,195 to A and $ 12,701 to B using the separate tax method. [n69] The effect of using the separate tax method is to reduce both A's and B's separate tax based on each spouse's relative income. This also takes into account the progressivity of the federal tax system. Thus, using the ratio of each spouse's separate tax appears to be the method of allocating the joint tax liability that should be used in most situations.

However, as discussed below, it may not work properly in all situations.

D. IRS Position -- Treasury Reg. § 20.2053-6(f)

In the estate tax area, the IRS has addressed the question of how to properly allocate a couple's joint tax liability in the year of death. It did so because it had to determine the proper deduction for the estate for the payment of the final income taxes owed by the decedent at the time of his or her death on a joint return. [n70] Treasury regulation section 20.2053-6(f) provides a formula to determine the allocation of the final year's income taxes between the decedent and the decedent's spouse. [n71] The regulation is summarized in Revenue Ruling 80-7 [n72] as follows:

> **[*511]** Section 20.2053-6(f) of the Estate and Gift Tax Treas. Regulations provides the method for determining the estate tax deduction allowed for income taxes paid on a decedent's final income tax return. Section 20.2053-6(f) provides that if the decedent's final return is a joint return, then the decedent's liability will be determined according to the following formula:
>
> (decedent's separate tax)/(both separate taxes) x (joint tax shown on the return)

As discussed above, this method appears to be a proper method of allocating the joint tax liability between the spouses in the absence of a different sharing agreement entered into by the spouses. This regulation has been cited in numerous cases in which the decedent's estate has unsuccessfully attempted to deduct the entire tax liability of the couple. [n73] This has probably occurred because prior to the passage of the unlimited marital deduction, if a deceased left a taxable estate, the tax deduction reduced the estate tax. Now that there is an unlimited marital deduction under section 2056 of the Code, no benefit generally is obtained by charging the final income tax to the estate, since there is generally no estate tax if the decedent's property is left to his or her spouse. [n74]

Although cases have generally acknowledged that the separate tax formula for allocating joint tax liability as **[*512]** proscribed in Treasury Regulation § 20-2053-6(f) is a proper method for allocating taxes, no examples are provided in the regulation, in case law or in Revenue Rulings demonstrating in detail how to calculate the "decedent's separate tax." In fact, the regulation does not even discuss the filing status to be used in making the "separate" calculations.

E. One Income Families -- A Possible Exception to the Separate Tax Liability Allocation Method

In *Maragon v. United States*, [n75] the taxpayers filed a joint return consisting entirely of Mrs. Maragon's income. She filed this action after being informed that the refund of $ 189.45 from her $ 518.92 withholding had been applied against her husband's prior year tax liability. The court held that Mrs. Maragon was entitled to the refund since her income was solely responsible for both the tax and the refund and since it made no difference that she filed a joint return. [n76] The court implicitly adopted an allocation method in which the joint tax liability and refund were allocated solely to Mrs. Maragon based on the fact that she was the only spouse with taxable income or separate tax. [n77]

Unfortunately, this normally acceptable method of allocation does not appear to be correct from an economic perspective. The difficulty with the separate tax allocation method is that it produces inequitable results at the extremes because none of the tax bonus is allocated to the non-earning spouse. This can be fatal to the filing of a joint return if a spouse knows that the non-earning spouse generally has three filing options: married filing separately with either one or two **[*513]** exemptions, [n78] or filing a joint return with the consent of both spouses. If A and B are married and A has $ 90,000 of income and B has no income, A's tax under each of the three filing alternatives is:

Filing Status:	MFS	MFS	Joint
Exemptions:	1	2	2
Tax [n79] :	$ 22,854	$ 22,026	$ 16,896
Tax savings versus			

married filing separately:	$ 0	$ 828	$ 5,130

The simple use of B's personal exemption is worth a tax reduction to A of $ 828. If B agrees to file a joint return, A's tax liability is $ 5,130 less than it would have been if A had filed as married filing separately. Under all of the allocation methods discussed above, however, B would not share in the $ 5,130 savings that A would receive under the recommended allocation method. This method allocates the joint tax liability based on A and B's relative tax, and since B has no income and thus no taxable income or income tax, B would not share in any of the refund.

If this were a business deal, such as a bank loan from B to A, rather than an allocation of taxes, B would receive "interest" for taking the risk of filing a joint return. It cannot be determined exactly how much B should receive for taking this risk. However, the use of a separate tax based allocation **[*514]** formula fails to take into account either that the marriage bonus saves A substantial taxes or that B is taking personal liability for the joint tax by filing a joint return.

Although it is unclear how A and B should share the tax bonus, some limits can be calculated. If A is unmarried, A's tax would be $ 21,184 compared to $ 22,854 if A files as married filing separately with one exemption. Thus, A's penalty is $ 1,670. If B agrees to file a joint return, the joint liability of $ 16,896 produces a $ 4,288 bonus compared to A's single tax of $ 21,184 and a $ 5,130 bonus compared to filing a separate return.

A similar problem exists if a separate loss is included in a joint return. Suppose that A has a current year loss of $ 90,000 and B has income of $ 90,000. If the normal separate tax allocation method is used, the joint liability of zero is allocated $ 0 to A and $ 0 to B. [n80] A will usually refuse to file a joint return, allowing A to carryback or carryforward the $ 90,000 net operating loss. [n81] A's refusal to file a joint return if B receives all of the "bonus" results in B owing a separate tax of $ 22,854. [n82] Thus, A and B should use a method other than the standard allocation method so that they can file a joint return and A's tax savings can be received by a payment from B.

A tax method exists for allocating taxes in this situation in the area of corporate consolidated tax returns where the loss of one corporation is used to offset the income of another. [n83] The consolidated return regulations provide for the election of two methods of allocation. Under the first method, the loss subsidiary only receives the tax bonus when it reports taxable income and therefore could have used its loss on a separate return basis. [n84] Under the second method, the loss subsidiary receives the tax bonus as soon as the parent benefits from the **[*515]** use of the loss. [n85] Although no regulations, rulings, cases, or articles suggest that the second approach should be used by individuals, this method appears to be a very simple approach to allocation where one spouse has a loss or no income for the year because it is easily calculated in the tax year. Requiring the proof of future benefits, although theoretically sound, would cause substantial problems, especially if the couple divorces prior to the realization of the benefit.

In cases other than those in which one spouse has a loss or no income, the proper method of allocation, consistent with Treasury Regulation 20.2036-6(f), is to allocate the joint tax liability based on each spouse's separate tax liability. Calculating a separate tax requires the calculation of taxable income which is dependent on adjusted gross income, less the standard deduction (or itemized deduction) and the personal exemptions. [n86] Since both the standard deduction [n87] and the tax rate schedule [n88] differ depending on the filing status of the taxpayer, the proper filing status must be determined.

F. Filing Status

Several possible filing statuses apply to individual taxpayers. They include single, head of household, married filing separately, and married filing jointly. [n89] Although no statutory or regulatory scheme exists for favoring one status over another in making the required separate tax calculation under Treasury Regulation 20.2053-6(f), Revenue Ruling 80-7 used the married filing separate filing status to calculate each spouse's separate tax liability. [n90] This is consistent with the **[*516]** theory of calculating the separate tax of each spouse because if separate returns were filed, that would generally be the required filing status. [n91] Thus, in making the separate tax calculation of each spouse, married filing separately statuses and standard deductions, where applicable, should be used.

G. Exemptions

Treasury Regulation 20.2053-6(f) does not mention personal exemptions. In calculating the separate tax of each spouse, Revenue Ruling 80-7 apparently did not reduce adjusted gross income by the taxpayer's personal exemption. n92 This is a major error in calculating the separate tax liability of each spouse because eliminating the exemption overstates taxable income **[*517]** and thus overstates each spouse's separate taxable income. [n93] The effect of overstating income depends on the adjusted gross income and the tax bracket of the taxpayer. [n94] The effect of $ 2,500 additional income from the loss of an exemption for each tax bracket follows:

Tax Bracket	Tax Cost - per each lost exemption
15%	$ 375
28%	$ 700
31%	$ 775
36% [n95]	$ 900

Not taking exemptions into account could cause A's separate tax liability to be overstated by $ 1,125 if A has three exemptions, even at the lowest tax bracket. Using the ruling's formula that disregards personal exemptions clearly overstates a taxpayer's separate tax. Accordingly, personal and dependency exemptions must be used to calculate each spouse's separate tax liability. It is not always clear, however, how to allocate the jointly claimed dependency exemptions when calculating the separate taxes. How should exemptions be allocated?

1. Personal Exemption

In calculating the separate tax liability of each spouse, an exemption should be given to each spouse for his or her own personal exemption. [n96]

[*518] *2. Dependency Exemptions*

If A and B are happily married and mutually support their child, who should receive the dependency exemptions when calculating their separate taxes? If they were divorced, the exemption would go to the custodial spouse [n97] unless they agreed in writing to treat the non-custodial parent as the provider of the support. [n98] Where the parents live together, Congress has not provided special provisions for filing separate returns, as it has where the parents are divorced. Accordingly, in most cases, the dependency exemption should be split evenly if the parents provide fairly evenly for their child's support. [n99] Where it is easy to trace the relative contribution of each spouse and it varies by a substantial amount, the exemption should probably be allocated entirely to the spouse who paid the overwhelming percentage of the child's support. Alternatively, there is no policy reason why the exemption should not be allocated on a pro-rata basis. [n100] In most cases, however, if the child's support is paid fairly evenly, it should be allocated one-half to each spouse. [n101]

[*519] If B provides all or a majority of the support for A's child, B should receive the entire exemption for purposes of allocation, even though B could not claim the exemption on a separate return. [n102] In addition to claiming exemptions for their children, taxpayers can also claim a dependency exemption for numerous relatives as well as any "individual . . . who has . . . as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household." [n103] These dependents should be allocated to the taxpayer who supports the dependent or if support is provided evenly, it should be allocated one-half to each spouse or pro-rated.

V. PRACTICAL PROBLEMS -- PREPARING THE SEPARATE RETURNS

The first task in calculating the separate tax liability of each spouse is to identify each item of income and deduction on the joint return and determine whether the item would be reported by the husband or the wife if they filed separately. If A and B are married and each brought their own stocks and bonds into the marriage, it is fairly easy to

determine which taxpayer should report the dividend and interest income. Determining how to allocate business income from a business owned prior to marriage may not be as simple. Analysis of the proper allocation of income and deductions between spouses is beyond the scope of this article, but some case law and several articles explain how to calculate each taxpayer's income when married filing separate returns are filed. [n104] Assuming that the task of allocating income and deductions to each spouse can be accomplished, calculating each spouse's separate tax is still a minefield full of tax compliance booby traps. This is because **[*520]** tax calculations on a separate return basis are often different than those on the joint return.

A. The Problem

Once the separate income and deductions of A and B are determined, simply calculating each's separate tax without regard to the joint return produces an unacceptable result in which the income and deductions "reported" on the separate returns differ from the amounts reported on the joint return. These inconsistencies are caused by two factors: statutory limitations and changes to those limitations based upon combined joint income or deductions.

B. Statutory Limitations

The first inconsistency is caused by the fact that statutory limits provided for married persons who file jointly, such as the limit of $ 3,000 for capital losses, [n105] generally are reduced to one-half that amount for married persons filing separately. [n106] For example, in calculating the separate liability of A, who has a separate capital loss of $ 4,000, it would be improper to limit A's loss to the separate limitation of $ 1,500 if in fact the joint limit of $ 3,000 is deducted on the joint return. [n107]

C. Effect of Combining Income on the Joint Return

The second inconsistency is caused by the fact that even the joint $ 3,000 statutory loss limitation is increased if A's spouse reports capital gain income. In the above example, suppose that A has a $ 4,000 capital loss and B has a $ 2,000 capital gain. On a separate return basis, A would be limited to $ 1,500. On a joint return, if B is not considered, A would be limited to $ 3,000. On the actual joint return, B would report $ 2,000 gain and **[*521]** therefore A's $ 4,000 loss would be allowed in full, since the couple's net capital loss would be only $ 2,000. [n108]

D. Solution

There is no universal solution to these problems. However, a practical two step solution works in most cases. In this solution, the first step is to use joint rather than separate return limitations in making the initial calculation of each spouse's separate tax liability. Thus, in calculating the initial separate returns of A and B, each could report capital losses up to the statutory $ 3,000 joint limitation. The second step is to compare the sum of the amounts reported on the separate returns of A and B to the amount reported on their joint return. If the two amounts are not equal, the separate returns must be recalculated consistent with the joint return.

In the above example, if A has a $ 4,000 capital loss and B has a $ 2,000 capital gain, the initial and "final" separate returns appear as follows (assuming that A and B have $ 30,000 and $ 60,000 of other income respectively):

Initial Separate Return of A and B and Joint Return

	A	B	Joint	Difference
Other income	$ 30,000	$ 60,000	$ 90,000	None
Capital gain/				
(loss)	(3,000)	2,000	(2,000)	(1,000)
AGI	$ 27,000	$ 62,000	$ 88,000	(1,000)

[*522] *After Adjustment, Separate Return of A and B and Joint Return*

	A	B	Joint	Difference
Other income	$ 30,000	$ 60,000	$ 90,000	None
Capital gain/ (loss)	(4,000)	2,000	(2,000)	None
AGI	$ 26,000	$ 62,000	$ 88,000	None

The same calculation and recalculation also applies to many itemized deductions which are limited by a percentage of adjusted gross income. Where only one spouse receives a deduction, such as where there is a casualty loss on A's property, the separate returns should be prepared as described above. First, A's return is calculated by reducing the casualty loss by 10% of A's adjusted gross income. [n109] The return is then recalculated, reducing A's casualty loss by 10% of the joint adjusted gross income.

If both spouses have casualty losses, preparing the separate returns becomes more complicated. How should the allowable joint casualty loss deduction be allocated if A and B have gross casualty losses of $ 8,000 and $ 3,000 [n110] and adjusted gross incomes of $ 30,000 and $ 60,000 respectively? The initial separate returns appear as follows:

Initial Separate Return of A and B and Joint Return

	A	B	Joint	Difference
AGI	$ 30,000	$ 60,000	$ 90,000	None
Casualty loss	(8,000)	(3,000)	(11,000)	None
Less 10% limitation	3,000	6,000	9,000	None
Net casualty loss	($ 5,000)	($ 0)	($ 2,000)	($ 3,000)

[*523] Initially, it appears that A should be allocated the entire $ 2,000 joint loss since only A received a casualty loss on a separate return basis. However, this analysis fails to take into account that if B's loss is not considered on the joint return, A's loss of $ 8,000 will be lost since A's casualty loss of $ 8,000 does not exceed $ 9,000, which is 10% of joint adjusted gross income. [n111] Thus, in the absence of B's contribution, A should not be allocated any of the joint loss on a separate return basis. However, because a joint casualty loss is allowable, it should be allocated pro-rata to A and B based on their respective gross losses. Accordingly, whenever an itemized deduction is phased out by a percentage of adjusted gross income, the separate deductions should be limited to the total deduction allowed on the joint return and that amount should be allocated based on each spouse's gross deduction. Using the pro-rata allocation in the above example, the casualty loss should be reallocated as follows:

After Adjustment, Separate Return of A and B and Joint Return

	A	B	Joint
AGI	$ 30,000	$ 60,000	$ 90,000
Casualty loss	(8,000)	(3,000)	(11,000)
Less 10% limitation (8/11 and 3/11)	6,545	2,455	9,000
Net Casualty loss [n112]	($ 1,455)	($ 545)	($ 2,000)

VI. TAX TREATMENT OF SPECIFIC ITEMS

The following is a list of various items in which the initial separate allocation may need to be recalculated because the sum of the amounts reported on the separate returns is different than the amount allowed on the joint return. Possible approaches to allocating a specific item will be discussed only if **[*524]** they are different from or help in understanding the pro-rata allocation method suggested above.

A. Social Security

On separate returns, social security benefits are taxable from the first dollar, whereas on a joint return, they are taxable only if joint modified adjusted gross income exceeds $ 32,000. [n113] As discussed above, the initial separate return should use the spouse's separate income but include the applicable percentage of social security benefits only if the separate modified adjusted gross income exceeds the joint statutory amount of $ 32,000. [n114] In some cases, the taxpayer will need to recompute the initial separate calculation to reflect the joint modified adjusted gross income of the couple. [n115]

B. Savings Bonds

Income from U.S. savings bonds used to pay higher education has different limits for single taxpayers and for married taxpayers filing separate and joint returns. Similar to social security benefits, the joint return phase out of $ 42,300 should be used in calculating the separate income of each spouse, and the separate tax should be recalculated if the joint return is inconsistent with the separate returns. [n116]

[*525] *C. Tax Benefit Rule*

Itemized deductions often are refunded in the following year. If a married taxpayer receives a refund of a previously reported deduction, it should be reported in income in the year received. [n117] For purposes of allocation between the spouses, this tax benefit income should be allocated in the same ratio as the gross deduction was originally allocated, unless the item can be specifically identified. [n118]

D. Section 179

Married taxpayers filing jointly can expense up to $ 17,500 of depreciable business property each year, [n119] whereas filing separately, they can deduct only half of that amount unless they elect otherwise. [n120] If A placed $ 17,500 of qualifying property in service and B placed $ 35,000 of qualifying property in service, should the joint deduction be allocated to A and to B based on total assets or should it be allocated equally to each? Assuming they both purchased 7-year MACRS property, the deduction probably should be allocated pro-rata based on the purchase of qualifying property up to the $ 17,500 statutory limit. In such a case, A and B would each receive a separate deduction of $ 8,750.

The deductible amount is not always $ 17,500. The deduction is reduced dollar for dollar by the amount by which section 179 property placed in service during the year exceeds $ 200,000. [n121] If A places $ 10,000 of qualifying property in service and B places $ 205,000 of qualifying property in service, A would be allowed $ 10,000 and B $ 12,500 on a separate return basis. On a joint return basis, they would be allowed only $ 2,500. Although there is no correct answer, the $ 2,500 probably should be **[*526]** reallocated evenly since both taxpayers' placed at least $ 2,500 of qualifying property in service.

The above pro-rata allocation should not be used if it conflicts with the property deducted on the joint return. In the above example, if A places $ 10,000 of qualifying 7-year MACRS property in service and B places $ 12,500 of 5-year MACRS property in service, the normal practice is to expense the 7-year property and depreciate the 5-year property. If the joint return reports a $ 2,500 deduction relating solely to A's property, then A should deduct $ 2,500 on a separate return basis. [n122]

E. Intra-Spousal Payments for Property

Transfers of property between spouses either during marriage or incident to their divorce are treated as gifts rather than sales for income tax purposes. n123 Thus, any transaction treated as a gift, such as the sale of a condominium between a wife and a husband, would not be subject to allocation, since it is treated as a gift rather than a sale for income tax purposes. n124 This creates strange tax results. If A's business spends $ 2,000 for a computer that cost B's computer shop $ 1,500, this is treated for income tax purposes as a gift of cash from A to B and a gift of the computer from B to A. n125 A's out-of-pocket cost is $ 2,000 but A's tax basis for the computer is only $ 1,500. n126 B's cash flow is $ 2,000 and B has an accounting profit of $ 500, but B has no taxable income because the "gift" of cash from A does not constitute taxable income. n127

[*527] *F. Intra-Spousal Payment for Services*

Unlike intra-spousal payments for products, intra-spousal payments for services are recognized for tax purposes. n128 Thus, if A pays B for deductible professional services, A can deduct the cost of the services and B must report the income received from A. On the joint return, these amounts will net to zero, but if A and B file separate returns, the amounts will reduce A's separate tax and increase B's. n129

If A makes a payment to B for business rent, is it a taxable payment for services or a non-taxable payment for property? Although Revenue Ruling 74-209 n130 held that such payments are deductible by A, it did not discuss the tax effect on B. Unfortunately, this ruling preceded the passage of section 1041 of the Code, which draws a distinction between payments for property and services. n131 In addressing this issue, the applicable regulation simply states that "transfers of services are not subject to the rules of section 1041 [of the Code]." n132 However, the regulation does not define the term "services" and does not provide any examples to indicate whether the payment of rent is considered a transfer of services or property. Until additional guidance is provided, some taxpayers may take the position that the rent is property while others may claim that the rent is a service. Regardless of how the issue is decided, the method chosen for the joint return should also be used on the separate returns.

G. Individual Retirement Accounts

The individual retirement account (IRA) deduction is reduced from $ 2,000 to zero if adjusted gross income on a joint return exceeds $ 40,000 and the taxpayer or the taxpayer's spouse is **[*528]** covered by a qualified pension plan. n133 For a separate return, no deduction is allowed for an IRA if either spouse is covered by a qualified plan. n134 Thus, when one spouse is not covered by a pension plan at work and would qualify for the $ 2,000 deduction on a separate return basis, the IRA deduction must be recalculated on a joint return basis, taking into account whether the spouse is covered by a qualified plan and the joint adjusted gross income. Another recalculation involves the $ 250 spousal IRA applicable to the non-working spouse. n135 Although applicable to the non-working spouse, the deduction should be allocated to the spouse who funds the IRA contribution.

H. Medical Expenses

Unlike other areas in which there are few examples of how to allocate individual items between spouses, there are numerous rulings providing examples of how to allocate the payment of deductible medical expenses between spouses. In cases where the expenses are paid out of community property, each spouse should be given a deduction for one-half of the qualifying medical expenses. n136 Where the expenses are paid out of a joint checking account in a separate property state, it is presumed that the payments are made equally by each spouse. n137 This presumption may be rebutted by competent evidence to the contrary, in which case a deduction can be claimed on a separate return for the medical expenses of the taxpayer, of the dependents and of the spouse. n138 Where the payments are made from the separate funds of one spouse, the deduction must be claimed by that spouse. n139

The total medical expenses are subject to a reduction of 7.5% of AGI on the joint return. n140 On the separate returns, the net **[*529]** allowable joint medical deduction should be allocated on a prorata basis based on each spouse's gross medical deduction, as demonstrated above in the casualty loss example (supra part V.D.).

I. Miscellaneous Itemized Deductions

As in the case of medical expenses, separately reported miscellaneous itemized deductions must be recalculated to reflect the joint reduction equal to 2% of joint adjusted gross income. n141 As discussed above, the only difficulty is determining which spouse paid each allowable miscellaneous itemized deduction on a separate return basis when a combination of joint and separate checkbooks are used to pay the bills. The rules discussed above in part VI.H., relating to medical expenses, illustrate how to make the allocation.

J. Casualty Losses

Personal casualty losses must be reduced by 10% of AGI. n142 Allocation of the joint allowable casualty loss should be made based on each spouse's gross casualty loss as discussed above. In calculating each spouse's share of a joint casualty loss, Revenue Ruling 75-347 n143 states that if a personal residence is owned by a married couple as tenants by the entireties, the casualty loss must be claimed equally by each spouse if separate returns are filed, regardless of who pays the cost of repairs. This reversed a 1939 ruling that permitted the loss to be claimed by the spouse who paid for the repairs. n144 Where separate returns are filed and the loss is allocated evenly, the loss should be split between the spouses, but the new basis **[*530]** should be allocated based on the cost of repairs paid by each spouse. n145

K. Charitable Contributions

Charitable contributions are limited to a maximum of either 50 percent, 30 percent or 20 percent of adjusted gross income. n146 Charitable contributions in excess of the joint limitations carryover to future years. n147 Where both spouses contribute cash to charity and the joint contributions exceed the 50 percent limitation, the allowable joint contribution should be allocated to each spouse based on the ratio of the allowable amounts on their respective separate returns to the allowable joint return deduction. n148

Where the spouses' separate contributions consist of both 50 percent and 30 percent contributions, the 50 percent charitable deductions are allowed prior to the 30 percent deductions. Rather than attempting to address this issue, the regulations simply point out that if there is a 30 percent carryover, the carryover would be allocated in a manner similar to the 50 percent regulations. n149 Unfortunately, no examples are provided in which one spouse makes only 50 percent contributions and the other spouse makes only 30 percent contributions with a 30 percent carryover. To illustrate, assume A and B are spouses with $ 100,000 of joint adjusted gross income, A contributes $ 50,000 cash to a church and B contributes $ 30,000 of appreciated long-term stock to the same church. A $ 50,000 charitable contribution is allowed for the cash contribution (the 50% contribution) and the entire $ 30,000 **[*531]** deduction is disallowed and treated as a 30% charitable contribution carryforward. n150 Accordingly, A would receive a separate deduction of $ 50,000 and B would receive no deduction, but B would receive the entire $ 30,000 carryover. n151 Similar rules apply if 20 percent contributions are made but are not allowed on the joint return.

L. Residential Interest

Qualified mortgage interest may be treated differently on separate returns for single taxpayers than on a joint return for a married couple because only two homes qualify for residential status for the married couple, whereas single taxpayers can each claim two qualified residences. n152 In addition, the limit on post-October 13, 1987, acquisition indebtedness is reduced from $ 1,000,000 on a joint return ($ 1,000,000 on a single tax return) to $ 500,000 for a married individual filing a separate return. n153 This can require a recalculation of the separate tax liability if the joint deduction would exceed $ 1,000,000 without this limitation. For example, suppose that A has a $ 900,000 home mortgage at 6 percent and B has a $ 600,000 home mortgage at 10 percent. On the joint return, the couple would deduct $ 600,000 of B's mortgage and only $ 400,000 of A's mortgage in order to obtain the largest possible joint deduction. On a separate return basis, however, should A receive a deduction for the amount paid on at least $ 500,000 of his or her mortgage?

There are at least two alternatives for allocating the interest expense between A and B. The simplest and the recommended alternative is to allocate the joint deduction as if each spouse **[*532]** claimed the interest on $ 500,000 of his or her respective loans (half the joint limitation), and allocate the remaining joint interest to B who paid interest at a higher rate than A. The separate and joint returns are calculated as follows:

Initial Separate Return of A and B and Joint Return

	A	B	Joint
Interest ($ 500,000 each)	$ 30,000	$ 50,000	$ 84,000 [n154]

Recalculation -- Separate Return of A and B and Joint Return

	A	B	Joint
Interest ($ 500,000 each remainder to B)	$ 30,000	$ 54,000	$ 84,000

An alternative method, which may be consistent with previous pro-rata allocations, is first to allocate to each spouse the interest on $ 500,000 of their respective loans, and then allocate the additional $ 4,000 to A and B based on their relative interest payments. The separate returns of A and B and the joint return appear as follows: **[*533]**

	A	B	Joint
Allocation Formula: (total interest paid)	$ 54,000	$ 60,000	$ 114,000
Interest deduction (on $ 500,000)	$ 30,000	$ 50,000	$ 84,000
(Additional allocation 54/114 and 60/114)	$ 1,895	$ 2,105	$ 4,000
Separate allocation	$ 31,895	$ 52,105	$ 84,000

Two unacceptable methods are an allocation of the total interest deduction based on the relative total interest paid by each spouse, and an allocation based on the relative principal loan balances. [n155]

M. Investment Interest Expense

A deduction for investment interest expense is allowed only to the extent of net investment income. [n156] In calculating investment income, itemized deductions are taken into **[*534]** account. [n157] Thus, if A has interest income of $ 8,000 and investment interest expense of $ 6,000 and B has no investment income but has $ 5,000 of investment expenses, such as stock brokerage fees, A is allowed a $ 6,000 investment interest expense deduction on a separate return, but on recalculation, A's deduction is limited to the joint return investment interest deduction of $ 3,000. The calculations are as follows:

Initial Separate Return of A and B and Joint Return

	A	B	Joint
Investment Income	$ 8,000	0	$ 8,000

Investment Expense	0	(5,000)	(5,000)
Allowable Investment			
Interest Expense	($ 6,000)	($ 0)	($ 3,000)

Recalculated Separate Returns of A and B and Joint Return

	A	B	Joint
Investment Income	$ 8,000	$ 0	$ 8,000
Investment Expense	0	(5,000)	(5,000)
Allowable Investment			
Interest Expense	($ 3,000)	($ 0)	($ 3,000)
Carryover:	$ 3,000		

As the chart demonstrates, all is not lost for A. A's disallowed interest expense of $ 3,000 will carryforward and can be used in subsequent years. [n158]

N. Capital Losses

Capital losses are allowed in an amount equal to the taxpayer's capital gains, plus $ 3,000 per year. [n159] Any amounts not utilized in the current year carryover to all future years until fully utilized. [n160] That rule is further complicated because **[*535]** there is an ordering provision describing which losses, short-term or long-term, are used first. [n161] In addition, carryover losses can affect these calculations. Thus, current joint utilization of net capital losses will depend on the nature and timing of the losses incurred by each spouse.

Where one spouse has net capital gains and the other has net capital losses and a joint return is filed, the gains offset the losses. Thus, if A has $ 7,000 of losses and B has $ 2,000 of gains, the separate returns of A and B would report a $ 3,000 loss and a $ 2,000 gain respectively. However, on a joint return basis, A is entitled to a $ 5,000 loss -- $ 2,000 to offset B's income plus the $ 3,000 additional loss on the joint return. [n162] B should include a $ 2,000 capital gain on a separate return basis.

Where both spouses incur losses, for example, if A has $ 10,000 of capital losses and B has $ 5,000, a $ 3,000 joint return loss is permitted. The allocation of the $ 3,000 on a separate return basis depends on the character of the respective losses. If there are both short-term and long-term capital losses, the short-term losses must be used first. [n163] Thus, the $ 3,000 should be allocated based on relative net short-term capital losses or allocated $ 1,500 each if both spouses have at least $ 1,500 of net short-term capital losses. If there are total short-term losses of less than $ 3,000, each spouse should be allocated his or her entire short-term loss and the remaining allowable long-term capital loss should be allocated to one of the spouses based on the relative long-term losses.

O. Section 1231 Gains

Income reported on a separate return as net section 1231 gain normally receives long-term capital gain treatment [n164] and thus a maximum tax rate of 28%. [n165] If, however, a spouse has reported net section 1231 losses over the previous five years, **[*536]** current section 1231 gain will be treated as ordinary income [n166] and taxed at the regular tax rates of up to 39.6%. Although a case can be made that the character should not be changed on a separate return basis, and the gain should be treated as long-term capital gain on the separate return, if consistency and uniformity are to be achieved between the separate returns and the joint return, the gain should be treated as ordinary income for all purposes. The effect of parallel treatment is that the spouse with section 1231 gain that is treated as ordinary income incurs a slightly larger tax liability than he or she would if the gain were reported as a section 1231 long-term capital

gain and the other spouse did not have section 1231 losses. An alternative approach, but not a suggested approach, is to treat A's section 1231 gain on a separate return basis without regard to the recharacterization as ordinary income which is caused by filing a joint return. The following example illustrates both alternatives and assumes that B reported $ 30,000 of net section 1231 losses in the prior year:

A. Recommended Approach: Consistent Treatment on Separate and Joint Returns:

Taxpayer	A	B	Joint
Ordinary income	$ 30,000	$ 60,000	$ 90,000
§ 1231 gain			
(ordinary gain)	30,000	0	30,000
AGI	$ 60,000	$ 60,000	$ 120,000
Tax	$ 12,861	$ 12,861	$ 25,722

[*537] *B. Alternative Approach: Inconsistent Treatment of Separate and Joint Returns:*

Taxpayer	A	B	Joint
Ordinary income	$ 30,000	$ 60,000	$ 90,000
§ 1231 gain			
(as capital gain)	30,000	0	
(ordinary gain)	0	0	30,000
AGI	$ 60,000	$ 60,000	$ 120,000
Separate Tax	$ 12,648	$ 12,681	$ 25,722
Allocated Tax	$ 12,754	$ 12,968	$ 25,722 [n167]

Under the recommended approach, the joint tax is split evenly, since A and B have identical taxable income and separate tax when the section 1231 gain is treated as ordinary income. Under the alternative approach, A's section 1231 gain is subject to the long-term capital gains maximum tax of 28% and therefore A's separate tax is slightly lower than B's, even though their gross income is the same. Thus, A pays $ 107 less than he or she would if A paid half the tax. Thus, the alternative approach increased B's tax liability even though the joint taxable income and tax liability did not change. [n168] Although it could be argued that this is fair since B probably benefited in the prior year from reporting a section 1231 loss, what was that benefit? The problem with this approach is the recharacterization of A's gain as ordinary income. Whether a couple believes that A should absorb the additional tax compared to what A would pay if he or she was not married will determine whether the suggested or alternative method should be used by a particular couple.

[*538] *P. Net Operating Loss Carrybacks and New (Old) Spouse*

If a joint return reports a net operating loss, the loss may be carried back three years or carried forward fifteen years. [n169] If the couple was not married during the carryback years or filed separate returns, or they file separate returns or are not married in the carryforward years owing to divorce or death, the current loss must be allocated separately to the appropriate spouse. [n170] Unlike the joint income tax which is allocated based on the couple's relative separate tax liability, the joint net operating loss is calculated for each taxpayer based on his or her separate net operating loss. [n171]

The regulation states that the separate net operating loss of a spouse that files a joint return:

> . . . shall be deemed to be that portion of the joint net operating loss . . . which is attributable to the gross income and deductions of such spouse, gross income and deductions being taken into account to the same extent that they are taken into account in computing the net operating loss. n172

For example, if the joint net operating loss is $ 1,000 and H has a separate loss of $ 700 and W has a separate loss of $ 300, those are their separate loss carryovers. n173 If the joint loss is $ 2,000 and H has income of $ 1,500 and W has a separate loss of $ 3,500, W's carryover is limited to the joint loss of $ 2,000. n174

If A carries back his or her separate net operating loss to a year in which A and B were not married, n175 A's loss only can be applied against A's income in that year. n176 For example, if A's current loss exceeds A's income in a joint return year filed with a prior spouse, C, A's loss only can be used to offset A's income even if C has sufficient income in that year to absorb all of A's **[*539]** remaining unused loss. n177 Assuming A has sufficient income in the prior year to use some or all of the loss, A will only receive a portion of the tax refund since the prior year's lower joint tax (reflecting A's carryback) must be reallocated based on A's and C's recomputed separate tax in the same manner in which the current tax liability is allocated between spouses. n178 A and C each should receive a portion of the refund based on the new ratios of their separate tax to the total separate taxes of the couple multiplied by the new joint tax liability. n179 Unfortunately for C, since the amended joint return can be prepared and filed by A without C's consent, n180 C may be unaware of the refund claim and therefore may fail to timely file a separate amended return to receive his or her share of the net operating loss refund. n181

Q. Passive Losses

In calculating the joint tax return of A and B, A's passive loss can be offset against B's passive income because spouses are **[*540]** treated as one taxpayer in calculating the passive loss limitations. n182 The regulation simply states:

> (j) SPOUSES FILING JOINT RETURN --
>
> (1) IN GENERAL. Except as otherwise provided in the regulations under section 469, spouses filing a joint return for a taxable year shall be treated for such year as one taxpayer for purposes of section 469 and the regulations thereunder. Thus, for example, spouses filing a joint return are treated as one taxpayer for purposes of -- . . .
>
> (i) Section 1.469-2T (relating to the computation of such taxpayer's passive activity loss). . . n183

Separate return recalculations may exist where taxpayers actively participate in losing real estate investments. In those cases, they are allowed to deduct up to $ 25,000 of passive activity losses, although this amount is phased out as adjusted gross income exceeds $ 100,000 on a joint return and $ 50,000 on a separate return. n184 In calculating the separate tax liability of each spouse, one initially should apply the $ 100,000 married filing jointly phase-out limitation and then recalculate based on the joint return adjusted gross income if the combined total is different than the spouses' separate returns.

If only one spouse has a loss, the joint return allowable loss should be allocated to that spouse on a separate return basis. If both spouses have active losses that total more than the amount allowed on the joint return, the allowable joint loss must be allocated. Unfortunately, the Service has not provided any guidance in this area. In an analogous area, the regulations provide that where spouses file a joint return in one year and a separate return in the next year, each spouse's carryover is determined by taking into account the items attributable to "such individual's interests in passive activities for the **[*541]** immediately preceding year." n185 The passive loss regulations further state that "spouses filing a joint return . . . must account separately for . . . the interests of each spouse in any activity." n186 Unfortunately, the

regulation provides no guidance or examples of how this separate accounting is performed.

Until guidance is provided by the Service, if both A and B have separate "allowable" active losses that exceed the joint allowable passive losses, each spouse's allowable share of the joint loss should be determined based on each spouse's relative separate allowable passive loss. Thus, if A has a separate loss of $ 10,000 and B has a separate loss of $ 20,000, each of which would be fully allowable on a separate return, the joint allowable loss should be allocated 1/3 to A and 2/3 to B, based on each spouse's relative allowable loss.

R. Sale of Principal Residence

The $ 125,000 exclusion on the sale of a principal residence is available to taxpayers age 55 or older, [n187] unless either the taxpayer or the spouse has previously filed a return which elected the exclusion. [n188] If a couple owns their home jointly and only one spouse is over 55, an election is permitted for the full $ 125,000 exclusion. [n189] The effect is that the spouse under 55, who would not qualify for the exclusion on a separate return basis, receives the benefit of the exclusion on a joint return basis. [n190] Accordingly, in calculating the separate tax of the spouse under 55, the joint return exclusion should be used. [n191]

A different situation exists if A sells his or her principal residence which would qualify for the $ 125,000 exclusion but **[*542]** does not receive the exclusion because B claimed the exclusion prior to the marriage to A. In this situation, A cannot claim the exclusion. [n192] Assuming B realized a tax savings from the use of the exclusion, [n193] should B reimburse A for the lost exclusion?

Suppose A and B are happily married, but live separately and each has a principal residence. If A is the first to sell a residence, should A and B share the savings received by claiming the one-time exclusion? If A is unwilling to share the savings, B can prevent A from claiming the exclusion by refusing to join in a joint return in the year of sale. [n194] In that case, A can not claim the exclusion and B can claim the exclusion in the future, unless A also refuses to file a joint return.

Rather than use the standard separate return allocation method in which case B may not agree to file a joint return with A, this situation is more favorably settled by a compromise between A and B in which they somehow allocate the tax benefits derived from the separate use of the one-time $ 125,000 exclusion.

S. Phase-Outs

Personal and dependency exemptions and most itemized deductions are phased out as joint adjusted gross income exceeds certain statutory amounts. On a joint return, personal and dependency exemptions are phased out by 2 percent for each $ 2,500 (or fraction thereof) by which the taxpayer's adjusted gross income exceeds $ 172,050. [n195] As for itemized **[*543]** deductions, taxpayers filing either a joint return or single return must reduce their itemized deductions for taxes, home mortgage interest, charitable contributions and miscellaneous itemized deductions by 3 percent of the amount that adjusted gross income exceeds $ 114,700, but not in excess of 80% of those deductions. [n196]

The question raised by the phase-outs is whether in calculating each spouse's separate tax, the phase-outs should be made on a joint or separate basis? Although there does not appear to be any authority on this issue, it appears that the most logical method of calculating the separate tax liability of A and B is to use limits as they apply on a separate return basis rather than try to reallocate the joint return limitations. [n197] The effect of not allocating the joint phase-outs to each spouse is that the lower income spouse often will benefit by lowering taxable income by the full amount of his or her personal exemptions and itemized deductions. An acceptable alternative is to allocate the phase-outs based on relative adjusted gross income, but this further complicates the already difficult task of calculating and recalculating each spouse's separate tax liability. [n198]

[*544] *T. Taxes and Credits*

Once the joint tax liability has been allocated, each spouse must reduce his or her liability by the amount of taxes paid, either through withholding, estimated tax payments or credits. The resulting total indicates either that the spouse is due a refund or owes additional taxes.

1. Withholding

In general, withholding taxes should be credited to the spouse whose wages were subject to the withholding. [n199] If the wages are community property income, the income is reported one-half by each spouse and the withholding tax is also credited one-half to each spouse. [n200]

2. Estimated Tax Payments

Separate estimated tax payments should be credited to the spouse who made each payment. [n201] Many couples, intending to file a joint return, file joint rather than separate estimates only to find that following a death or a divorce they have to file a separate return. [n202] The regulation states that joint estimated taxes may be divided between the spouses in such manner as they may agree. [n203] If the couple cannot agree, one revenue ruling states that estimated taxes should be allocated, by analogy to regulation section 20.2053-6(f) and regulation section 1.6015(b)-1(b), [n204] according to the following formula:

[*545] Separate tax liability/Both separate tax liabilities x Estimated tax payments

The position of the Service in this area is not consistent with the true economic practice of the taxpayers. Why should an allocation formula be used simply because the couple cannot agree? If a joint estimated tax payment is made from the separate property of one spouse, that spouse should receive credit for the payment just as he or she would receive credit if the payment were made through withholding from an identifiable paycheck. The fact that a joint voucher rather than a separate voucher was filed should not be the determinative factor. Unfortunately, in the absence of proof of an agreement to the contrary, the courts will follow the regulation. [n205]

Another problem with using the Service's formula is that it fails to take into account that estimated tax payments are often based on prior years income tax, not on the current separate tax liability of each spouse. [n206] Also, when using the estimated tax formula there is no reason for allocating the joint estimated tax payment, which by definition is an estimate of the current year tax, on a formula that is based on the actual current tax liability, since these two formulas are almost always different.

Another problem with the formula approach is that many first quarterly estimated tax payments are made using a prior year's overpayment, [n207] which could have been refunded. If it had been refunded, it would have been allocated based on the **[*546]** prior year's tax allocation. Why, simply by applying the overpayment, does it become allocated based on facts that can only be determined after year's end? Applying an overpayment to the subsequent year should not convert what would be A's property into B's property because a different allocation formula is used.

Rather than fight a losing battle with the Service, one solution is to prepare separate estimated tax vouchers for each spouse each year. This entails substantial additional accounting for the couple since it requires them to prepare separate estimates. If they wind up filing separate returns, this will eliminate all issues of allocation. If they file a joint return or agree on how to allocate the estimates, this is a great deal of work for nothing.

3. Estimated Tax Penalty

The regulations provide several examples which illustrate how to calculate the estimated tax penalty in the case of a taxpayer who files a separate return for the current year and a joint return for the preceding year. [n208] The regulation's methodology is consistent with the methodology suggested in this article. It allocates the prior years joint liability based on the ratio of the separate tax of each spouse in a manner almost identical to that used in regulation section

20.2053-6(f), but without giving any examples on how to allocate items that are treated differently on the separate and joint returns. [n209] A similar approach should be taken if a couple files a joint return and owes an estimated tax penalty. The first step is to allocate the joint liability to each spouse. The second step is to allocate the withholding and estimated tax payments to each spouse. The third step is to prepare the separate estimated tax penalties. The final step is to allocate the joint estimated tax liability to each spouse based on the ratio of each spouse's separate estimated tax penalty. [n210]

[*547] *4. Alternative Minimum Tax*

The alternative minimum tax on a separate return differs from that of a joint return. The exemption is $ 45,000 for a joint return but only $ 33,750 for a single return and $ 22,500 for a married filing separate return. [n211] The phase-out of the alternative minimum tax exemption occurs at alternative minimum taxable incomes of $ 150,000 for a married filing joint return, $ 112,500 for a single return and $ 75,000 for a married filing separate return. [n212] Thus, as discussed above, an initial separate return and a recalculated return should be prepared and the penalty allocated based on the separate relative alternative minimum taxes. [n213]

5. Self-Employment Tax

Social security and Medicare taxes imposed on wages are not part of the joint taxes allocated by the couple, except in the case of overpaid social security taxes resulting from employment by more than one employer. [n214] In that case they should be treated as additional wage withholding. It follows that an equivalent tax, the self-employment tax, [n215] should be allocated solely to the self-employed spouse, except in community property states. In calculating the self-employed spouse's income, the employer's one-half of the self-employment tax which is deductible from adjusted gross income [n216] should be deducted.

Accordingly, in the following example, if B has $ 32,281 of self-employment income, A should pay the regular allocation of taxes of $ 12,701 [n217] and B should pay the regular allocation of **[*548]** taxes $ 4,195 [n218] as if the net earnings are $ 30,000, plus the self-employment taxes ("S.E. Tax") of $ 4,561.

Example of Self-Employment Tax Calculation:

	A	B	Joint
Ordinary Income	$ 60,000	$ 0	$ 60,000
Self-Employment Income	0	32,281	32,281
Less: 1/2 S.E. Tax	0	(2,281)	(2,281)
AGI	$ 60,000	$ 30,000	$ 90,000
S.E. Tax	0	$ 4,561	$ 4,561
Income Tax	$ 12,701	$ 4,195	$ 16,896
Total Tax	$ 12,701	$ 8,756	$ 21,457

6. Foreign Tax Credit

The regulations provide some guidance in allocating carryovers from separate returns to joint returns and from joint returns to separate returns. [n219]

7. Earned Income Credit

If the taxpayers are entitled to an earned income credit, [n220] Revenue Ruling 87-52 provides a method of allocating a prior earned income credit which is similar to that used for allocating the joint income tax. [n221]

[*549] *8. Investment Credit*

The investment tax credit should be charged on a separate return basis to the taxpayer who purchased the qualified property. Investment tax credit recapture should be charged to the same taxpayer. Revenue Ruling 67-431 [n222] provides that when an investment tax credit is carried back to a joint return with a former spouse, the entire credit is allocated to the spouse who earned the credit.

9. IRA/Pension Penalty

The 10% penalty applicable to the taxable distribution of a pension or IRA prior to age 59 and 1/2 is applicable solely on that specifically identifiable income. [n223] The penalty should therefore be allocated on a separate return basis to the spouse who receives the premature distribution.

VII. CONCLUSION

Married taxpayers filing joint returns who do not share their income and deductions evenly often face a very difficult task in trying to allocate their joint income tax liability. Many taxpayers who do not face complicated calculation issues either do not realize that they should allocate the joint tax, or they do not spend the time or effort necessary to properly identify their separate property much less allocate their joint tax liability. Others may think about allocating their joint tax liability but decide the task is far too complicated to perform or they may find that a professionally prepared allocation costs more than the benefit received. Some couples simply avoid a joint return in favor of filing separate returns.

[*550] Tax professionals attempting to allocate their clients' joint tax liability are provided almost no meaningful regulatory guidance. Thus, significant questions remain unanswered as to the proper method of preparing an allocation of the joint tax liability and the proper calculation of the separate tax liability of each spouse. Allocating the joint tax liability should not be so difficult that even a tax professional is left with significant unanswered questions. However, until Congress eliminates the marriage penalty and bonus, questions will remain when trying to allocate joint income taxes.

Legal Topics:

For related research and practice materials, see the following legal topics:
Estate, Gift & Trust LawCommunity PropertyGeneral OverviewTax LawFederal Taxpayer GroupsIndividualsFiling Status (IRC secs. 1-2)Tax LawState & Local TaxesIncome TaxGeneral Overview

FOOTNOTES:

n1 See, e.g., Marjorie E. Kornhauser, Love, Money, and the IRS: Family, Income-Sharing, and the Joint Income Tax Return, 45 Hastings L.J. 63 (1993-94); Ellen E. Schultz, Marriages Could Become Too Dear if Changes in Tax Law Go Through, Wall St. J., Feb. 18, 1993, at C1.

n2 See Jane Bryant Quinn, Proposed Working-Couple Tax Credit Would Offset So-Called 'Marriage Tax', Buffalo News, April 29, 1995, at B13, (pointing out that "(T)his bill overlooks the marriage bonus that one-earner couples enjoy -- which is equally unfair.").

n3 See Boris I. Bittker, Federal Income Taxation and the Family, 27 Stan. L. Rev. 1389, 1396-97 (1975).

n4 For the purposes of this article, all calculations are based on the 1995 tax rates. It is assumed that each taxpayer uses the standard deduction and therefore taxable income is:

Gross income	$ 29,750
Less:	
Standard deduction	(3,900)
Personal exemption	(2,500)
Taxable income	$ 23,350

Those taxpayers whose filing status would be head of household or surviving spouse would obtain a different result, as would those taxpayers who itemize rather than claim a standard deduction.

n5 The joint taxable income is calculated as follows:

Gross income	$ 59,500
Less:	
Standard deduction	(6,550)
Personal exemptions (2)	(5,000)
Taxable income	$ 47,950

n6 The $ 1,351 penalty is made up of two parts, a tax rate penalty and a taxable income penalty. The tax rate penalty is caused by the fact that single taxpayers in the above example are taxed on all of their income at the 15% rate whereas $ 8,950 of the joint return income is taxed at the 28% tax rate. I.R.C. §§ 1(a) and (c). This rate difference results in a penalty of $ 1,164. The remaining $ 187 results from the different standard deductions. Married couples receive a $ 6,550 standard deduction whereas single taxpayers receive a standard deduction of $ 3,900 each or a total of $ 7,800. This $ 1,250 additional income is subject to tax at a 15% tax rate, causing the remaining $ 187 tax penalty.

The penalty is even higher for seniors and blind taxpayers who claim the standard deduction because, under I.R.C. § 63(f), single taxpayers are given an additional standard deduction of $ 950 for being at least 65 years of age or legally blind whereas each married taxpayer receives only a $ 750 additional standard deduction for being at least 65 years of age or blind.

n7 Head of household filing status can not be claimed even if the couple lives together the entire year, since the taxpayer and friend are not related. I.R.C. § 2(b)(3)(B)(i). An extra exemption can be claimed only if the "unmarried spouse's" gross income is less than the exemption amount of $ 2,500, I.R.C. § 151(c)(1)(A), and if the couple lives together the entire year. I.R.C. § 152(a)(9).

n8 Taxable income is calculated as follows:

Gross income	$ 59,500

Less:	
Standard deduction	(3,900)
Personal exemption (2)	(5,000)
Taxable income	$ 50,600

n9 The additional tax for the single taxpayer is a result of the standard deduction and the tax rates, which change as the taxpayer's filing status changes from single, to head of household, to married filing joint. The standard deduction amounts and the 28% marginal tax rate thresholds are summarized as follows:

Taxpayer Status	28% tax rate on Income over	Standard Deduction
Single	$ 23,350	$ 3,900
Head of household	$ 31,250	$ 5,750
Joint return	$ 39,000	$ 6,550

If the taxpayer can not claim an additional dependency exemption for the "unmarried spouse," taxable income is $ 53,100 and the tax of $ 11,833 produces a marriage bonus of $ 3,477.

n10 First Comes Love, Then Comes Marriage, Then Comes . . . the IRS, Accounting Today, April 24, 1995, at 11.

n11 Id.

n12 Robert H. Shaw, Married Lawyer Says Marriage Penalty is an 'Exercise of Government Power on the Side of Immorality,' 67 Tax Notes 1589 (1995) (summary of author's letter in which he comments that he was shocked to discover that by filing a joint return, his taxes were $ 3,000 higher than if he had remained unmarried).

n13 Daniel R. Feenberg and Harvey S. Rosen, Recent Developments in the Marriage Tax, NBER Working Paper No. 4705 (1994).

n14 Id.

n15 The average was calculated as follows:

	Percentage	Average	Net
Penalty	52%	$ 1,244	$ 646.88
Bonus	38%	($ 1,399)	($ 531.62)

Neither	10%	$ 0	0
Total	100%	N/A	$ 115.26

n16 Kornhauser, supra note 1, at 64. See also Michael J. Graetz, Tax Policy at the Beginning of the Clinton Administration, 10 Yale J. on Reg. 561, 569 (1993)(demonstrating that some high income taxpayers face a $ 13,000 penalty per year).

n17 Suppose A and B are both 55 years old and have lived together for over 3 years in a jointly owned principal residence. If they are married, they can exclude only $ 125,000 of the gain from the sale of their personal residence. I.R.C. § 121. If they are unmarried, they can exclude $ 250,000, $ 125,000 each. Based on the 28% maximum tax rate on longterm capital gains provided in I.R.C. § 1(h), the exclusion of an additional $ 125,000 of gain results in a tax benefit to an unmarried couple of $ 35,000, plus additional state tax savings.

n18 Dennis R. Lassila and Casper E. Wiggins, Marriage Tax Penalties (Bonuses) of Elderly Taxpayers After OBRA '93, 70 Tax Notes 109, 110 (1996).

n19 Taxable income and the income tax liability of a married couple earning adjusted gross income of $ 90,000 is:

AGI	$ 90,000
Less:	
Personal exemptions (2)	(5,000)
Standard deduction	(6,550)
Taxable income	$ 78,450
Federal income tax	$ 16,896

n20 The following chart calculated the marriage penalty and bonus on gross income of $ 90,000 for 1995:

A's gross income	B's gross income	A's tax, if single	B's tax, if single	Total separate tax of A + B
0	90,000	0	21,184	21,184
10,000	80,000	540	18,084	18,624
20,000	70,000	2,040	14,984	17,024
Break Even				
20,800	69,200	2,160	14,736	16,896
30,000	60,000	3,573	11,973	15,546
40,000	50,000	6,373	9,173	15,546
45,000	45,000	7,773	7,773	15,546
50,000	40,000	9,173	6,373	15,546

60,000	30,000	11,973	3,573	15,546
Break Even				
69,200	20,800	14,736	2,160	16,896
70,000	20,000	14,984	2,040	17,024
80,000	10,000	18,084	540	18,624
90,000	0	21,184	0	21,184

n21 Julian Block, Even When You Say I Do Can Have Big Tax Effect, Chi. Trib., Dec. 9, 1991, at Business 7.

n22 Wendy C. Gerzog, The Marriage Penalty: The Working Couple's Dilemma, 47 Fordham L. Rev. 27 (1978-79); Lawrence Zelenak, Marriage and the Income Tax, 67 S. Cal. L. Rev. 339 n.11 (1994) (listing anecdotes of high income couples considering divorce to save taxes); James Almand & Leslie A. Whittington, Income Taxes and the Marriage Decision, 27 Applied Economics 25-31 (Jan. 1995).

n23 In order to achieve the benefit of the two exclusions, the Internal Revenue Service ("IRS" or the "Service") thinks that some couples might attempt to divorce in the year of sale and remarry early the following year. In Rev. Rul. 76-255, 1976-2 C.B. 40, the Service ruled that such divorces will not be respected for purposes of the federal tax laws.

See also Boyter v. Comm., 668 F.2d 1382 (4th Cir. 1981) (holding that the sham transaction doctrine may apply to those couples that divorce and immediately remarry); Note, The Haitian Vacation: The Applicability of Sham Doctrine to Year-End Divorces, 77 Mich. L. Rev. 1332 (1979)(anticipating the Service's challenges to divorces obtained in foreign jurisdictions).

n24 Divorced and $ 18,000 Richer, The Washington Post, February 3, 1981, at B5.

n25 42 U.S.C. § 402(b) (1995) (relating to a wife or a divorced wife); 42 U.S.C. § 402(c) (1995) (relating to a husband or a divorced husband). There is presently a requirement that in order to collect benefits based on a former spouse's wages, the duration of the marriage must be at least 10 years. 42 U.S.C. § 416(d)(1) (1995) (divorced wife); 42 U.S.C. § 416(d)(4) (1995) (divorced husband).

n26 I.R.C. § 2056.

n27 I.R.C. § 2523.

n28 See Toni Robinson & Mary Moers Wenig, Marry in Haste, Repent at Tax Time: Marital Status as a Tax Determinant, 8 Va. Tax Rev. 773 (1989) (comparing the tax consequences for single, married and separated persons); Jeannette Anderson Winn & Marshall Winn, Till

Death Do We Split: Married Couples and Single Persons Under the Individual Income Tax, 34 S.C. L. Rev. 829, 838-40 (1983); Note, Federal Income Tax Discrimination Between Married and Single Taxpayers, 7 U. Mich. J.L. Ref. 667, 670 (1973).

n29 Charles Phillips Gilliam, Comments, Marital Status and Individual Income Taxation: The Equitable Issues, 1981 Det. C.L. Rev. 1037, 1099-1100 (1981).

n30 According to one author, there are 5 maxims for a "just" tax system, 1: families with the same income should pay equal taxes, 2: persons with equal income should pay equal taxes, 3: marrying should not increase one's tax, 4: being single should not increase one's tax, and 5: tax rates should be progressive. Gilliam, supra note 28, at 1100 n.265.

n31 See Anne L. Alstott, Alleviating Marriage Penalties in The Income Tax and the Earned Income Tax Credit, 66 Tax Notes 1343 (1995) (statement given before the House Ways and Means Committee, January 17, 1995); Pamela B. Gann, Symposium: The Economic Recovery Tax Act of 1981: The Earned Income Deduction: Congress's 1981 Response to the "Marriage Penalty" Tax, 68 Cornell L. Rev. 468 (1983) (arguing that only separate individual returns can equitably resolve the marital tax issue).

n32 Gilliam, supra note 28, at 1101; See Philip J. Harmelink and Walter Krause, Tax Neutrality Toward Marital Status: Analysis and Proposals, 30 Kan. L. Rev. 51 (1981) (addressing various efforts to reform marital taxation).

n33 It is interesting that although there are many articles which discuss the marriage penalty, virtually none discuss the practical implications for a couple. One author suggests repealing the joint tax liability and allocating the liability based on the separate proportional liability of each spouse. *See* Richard C.E. Beck, The Innocent Spouse Problem: Joint and Several Liability for Income Taxes Should Be Repealed, 43 Vand. L. Rev. 317, 393-400 (1990).

n34 According to Professor Bittker, the marriage penalty is the result of three separate policies, equal taxes for all married couples, trying to equalize the taxes of single and married taxpayers and progressive taxes. For the reason these three policies can not be achieved simultaneously, see Boris I. Bittker, Federal Income Taxation and the Family, 27 Stan. L. Rev. 1389, 1429-1431 (1975).

n35 James Edward Maule, Tax and Marriage: Unhitching the Horse and Carriage -- But Let There Be Spaces in Your Togetherness, 67 Tax Notes 539 (April 24, 1995).

n36 See Perry Abbott & Terry Witt, Planning for Tax Savings by Filing Separate Returns in Community Property States, 3 Comm. Prop. J. 113 (1976); and Susan Kalinka, Federal Taxation of Community Income: A Simpler and More Equitable Approach, 1990 Wisc. L. Rev. 633.

n37 Michael E. Weber, Individual Income Tax Returns, 1993: Early Tax Estimates, 14-2 Stat. Inc. Bull. 11, 20 (1994).

The actual number of couples filing married filing joint returns for 1991 was 48,720,459 as compared to 2,298,928 filing separate returns. IRS Pub. No. 1304, Individual Income Tax Returns 1991 (Rev. 1994) at table 1.3.

n38 The Service may look to both spouses to pay the joint tax liability, regardless of each spouse's allocable share of the income or deductions. I.R.C. § 6013(d)(3).

n39 Lawsuits seeking a share of the joint tax liability or seeking to require one's spouse to join in filing a joint return generally occur only in a divorce proceeding or in the probate of an estate and most of those cases are not reported.

See In re Marriage of Partridge 276 Cal.Rptr. 8, 13 (Cal.App.3 Dist. 1990), in which the court required a spouse to file a joint return in order to reduce the community property tax debt. The joint debt was split after giving the wife credit for a $ 600 refund received on a separate return refund. But see Banks v. Banks, 648 So. 2d 1116, 1127-28 (Miss. 1994), in which the court states that a divorce agreement to cooperate with one another in filing all tax returns does not require the filing of a joint return, even though it might have saved one spouse over $ 30,000.

n40 Although married couples are not required to file a joint return, if they do, they are jointly and severally liable for the entire tax. I.R.C. § 6013(d)(3). Even under the Revenue Act of 1918, the Service warned taxpayers that both parties to a joint return are personally liable for the entire tax, without regard to their respective share of the tax. I.T. 1575 1923-II C.B. 144. Thus, the answer to this question is only relevant to the couple and of no consequence to the Service.

n41 Although not married at the end of the year, a joint tax return is permitted in the year of a spouse's death, unless the surviving spouse is married on the last day of the year. I.R.C. § 7703(a)(1).

n42 The nine states which have community property laws are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. In general, there is no need to allocate the joint tax liability in community property states, because the income from community property is taxable equally to each spouse.

If either spouse has separate property however, such as from gifts, inheritances or property acquired prior to marriage, they may not have equal income. It is very common to have separate property in second marriages or later marriages in which one or both spouses has accumulated substantial assets prior to marriage.

n43 Thus, in a community property state, his bank account is hers and hers is his. Add them up at the end of the year and they each own one-half of the whole. Thus, it does not matter whose withholding or whose bank account is used to pay each years tax liability.

n44 Shapiro v. Shapiro, 224 A.2d 164, 168 (Pa. 1966). See also In re Marriage of Walter 129 Cal. Rptr. 351, 353 (Cal.App.1 Dist. 1976); In re Estate of Turner 96 P.2d 363, 364-65 (Cal.App.2 Dist. 1939) where the husband paid the property taxes on his separate property with community property funds and the court found that the wife was entitled to repayment.

n45 Young v. Young 376 A.2d 1151, 1157 (Md.Ct.Spec.App. 1977) (payment of taxes on jointly owned property presumed to be a gift). See also Dunn v. Mullan 296 P. 604, 607 (Cal. 1931).

n46 Honickman v. Commissioner 58 T.C. 132, 138 (1972).

n47 For an article stating that the final taxes must be paid in an appropriate amount, see C.T. Foster, Annotation, Liability of Executor or Administrator to Estate Because of Overpaying or Unnecessarily Paying Tax, 55 A.L.R.3d 785 (1994).

n48 I.R.C. § 2053.

n49 The married filing joint tax liability for 1995 for all of the following cases is calculated as follows:

AGI	$ 90,000
Less:	
Personal exemptions (2)	(5,000)
Standard deduction	(6,550)
Taxable income	$ 78,450
Federal income tax	$ 16,896

n50 Relative AGI for 1995 would be as follows:

	A	B	Joint
AGI	$ 30,000	$ 60,000	$ 90,000

The ratios would therefore become:
A = $ 30,000 / 90,000 = 33.33%
B = $ 60,000 / 90,000 = 66.67%

n51 If taxable income is used and married filing separate filing status is used, the relative taxable incomes for 1995 would be as follows:

	A	B	Joint
AGI	$ 30,000	$ 60,000	$ 90,000
Less:			
Standard Deduction	(3,275)	(3,275)	(6,550)
Personal Exemption	(2,500)	(2,500)	(5,000)

Taxable income	$ 24,225	$ 54,225	$ 78,450

The ratio of A and B's taxable income would therefore become:
A = $ 24,225 / 78,450 = 30.88%
B = $ 54,225 / 78,450 = 69.12%

n52 Using a single filing status, the relative taxable incomes for 1995 would be as follows:

	A	B	Joint
AGI	$ 30,000	$ 60,000	$ 90,000
Less:			
Standard Deduction	(3,900)	(3,900)	(7,800)
Personal Exemption	(2,500)	(2,500)	(5,000)
Taxable income	$ 23,600	$ 53,600	$ 77,200

The ratio of A and B's taxable income would therefore become:
A = $ 23,600 / 77,200 = 30.57%
B = $ 53,600 / 77,200 = 69.43%

n53 Using a filing status of married filing separately, the relative income tax for 1995 would be as follows:

	A	B	Joint
AGI	$ 30,000	$ 60,000	
Less:			
Standard Deduction	(3,275)	(3,275)	
Personal Exemption	(2,500)	(2,500)	
Taxable income	$ 24,225	$ 54,225	
Federal income tax	$ 4,248	$ 12,861	$ 17,109

The ratio of A and B's federal income tax would therefore become:
A = $ 4,248 / 17,109 = 24.83%
B = $ 12,861 / 17,109 = 75.17%

n54 Using a filing status of single, the relative income tax for 1995 would be as follows:

	A	B	Joint
AGI	$ 30,000	$ 60,000	
Less:			
Standard Deduction	(3,900)	(3,900)	
Personal Exemption	(2,500)	(2,500)	
Taxable income	$ 23,600	$ 53,600	
Federal income tax	$ 3,573	$ 11,973	$ 15,546

The ratios would therefore become:

A = $ 3,573 / 15,546 = 22.98%
B = $ 11,973 / 15,546 = 77.02%

n55 Using a filing status of single A and B's tax liability would be calculated as follows:

	A	B	Total
AGI	$ 30,000	$ 60,000	
Less:			
Standard Deduction	(3,900)	(3,900)	
Personal Exemption	(2,500)	(2,500)	
Taxable income	$ 23,600	$ 53,600	
Federal income tax	$ 3,573	$ 11,973	$ 15,546

n56 The tax liability of A and B if they are single compared to their joint tax liability is as follows:

	A	B	Total
Income	$ 30,000	$ 60,000	$ 90,000
Tax (Single)	$ 3,573	$ 11,793	$ 15,546
Tax (Married filing joint)			$ 16,896

n57 At first blush, it would not appear that filing status is relevant to the calculation of adjusted gross income. However, as can be seen in I.R.C. § 86(c)(1), a portion of social security is taxable from dollar one for married taxpayers filing separately. If the same taxpayer were single or married and filing a joint return, social security would become taxable only if modified adjusted gross income exceeds $ 25,000 and $ 32,000, respectively.

n58 IRS Pub. No. 1304, supra note 36, at table 1.2, reports that in 1991, 22,624,872 joint returns reported itemized deductions and 25,662,200 reported standard deductions. When subtracting out returns with incomes under $ 10,000 in which little if any tax would be due, the percentages are approximately equal.

n59 I.R.C. § 63.

n60 Rev. Rul. 74-486, 1974-2 C.B. 56.

n61 Id. The ruling states that if the taxpayer is jointly and severally liable for the full amount of the tax, then a deduction may be claimed for the total amount paid by each spouse. Id.

n62 It is clearly wrong if the ruling's use of the term "gross income" is intended to be gross income under I.R.C. § 61. For example, suppose that A has gross income of $ 50,000 and adjustments to income for alimony paid of $ 15,000, an adjustment allowed in the calculation of AGI under I.R.C. § 62. If B has gross and adjusted gross income of $ 50,000, does the Service believe that they should share their joint state tax liability equally? At a minimum, the ruling should require the use of adjusted gross income.

n63 Taxable income is calculated as follows for A and B, married filing separately and for a joint return:

	A	B	Joint
AGI	$ 30,000	$ 60,000	$ 90,000
Less:			
Standard Deduction	(3,275)	(3,275)	(6,550)
Personal Exemption	(2,500)	(2,500)	(5,000)
Taxable income	$ 24,225	$ 54,225	$ 78,450

n64 $ 4,248 / 24,225 = 17.57%

n65 12,861 / 54,225 = 23.72%

n66 The joint average tax rate is: 16,896 / 78,450 = 21.50%

n67 A = $ 24,325/(24,225 + 54,225) x 16,896 = $ 5,217

B = $ 54,225/(24,225 + 54,225) x 16,896 = $ 11,697

n68 Using a filing status of married filing separately, the relative income tax for 1995 would be as follows:

	A	B	A + B
AGI	$ 30,000	$ 60,000	
Less:			
Standard Deduction	(3,275)	(3,275)	
Personal Exemption	(2,500)	(2,500)	
Taxable income	$ 24,225	$ 54,225	

Federal income tax	$ 4,248	$ 12,861	$ 17,109

Although this appears to be a tax bonus situation, in that the joint tax liability of $ 16,896 is less than $ 17,109, this is actually a tax penalty situation. If A and B were not married, their combined separate tax liabilities would $ 15,546, based on single return liability of $ 3,573 and $ 11,973 respectively.

n69 The ratio of A and B's federal income tax and the allocation of the $ 16,896 joint tax liability is therefore:

A = $ 4,248 / 17,109 = 24,83% x $ 16,896 = $ 4,195

B = $ 12,861 / 17,109 = 75.17% x $ 16,896 = $ 12,701

n70 I.R.C. § 2053.

n71 Treas. Reg. § 20.2053-6(f) provides in pertinent part:

> (f) INCOME TAXES. Unpaid income taxes are deductible if they are on income property includible in an income tax return of the decedent for a period before his death.
>
> . . .
>
> In the absence of evidence to the contrary, the deductible amount is presumed to be an amount bearing the same ratio to the total joint tax liability for the period covered by the return that the amount of income tax for which the decedent would have been liable if he had filed a separate return for that period bears to the total of the amounts for which the decedent and his spouse would have been liable if they had both filed *separate returns* for that period.

Treas. Reg. § 20.2053-6(f) (emphasis added).

n72 Rev. Rul. 80-7, 1980-1 C.B. 296, 297.

n73 It does not appear to be the proper method if the estate is required to pay the entire tax because the spouse is insolvent not because the allocation is wrong, but because the estate is jointly and severally liable for the entire joint tax liability. Thus, if the surviving spouse is unable to pay, a bad debt should be allowed under I.R.C. § 2053.

Even if a spouse or an estate has a statutory or contractual right of contribution from a spouse for having paid the entire joint tax liability of the couple, a bad debt loss has been denied when that right became worthless. Rude v. Commissioner, 48 T.C. 165, 174-175 (1967). If a bad debt were allowed, the effect would be the deduction of federal income taxes which is prohibited. Globe Products Corp. v. Commissioner, 72 T.C. 609, 618 (1979) (citing I.R.C. § 275).

n74 See Johnson v. United States, 742 F.2d 137, 140-141 (4th Cir. 1984); McClure v. United States, 288 F.2d 190, 191-192 (Ct. Cl. 1961); Estate of Pridmore v. Commissioner, 20 T.C.M. (CCH) 47, 53 (1961).

Accordingly, the allocation formula adopted by Treas. Reg. § 20.2053-6(f) is unlikely to be litigated since most executors will allocate the final joint federal income tax, if they realize that an allocation is necessary and that there is a regulation on the subject.

n75 153 F.Supp. 365 (Ct.Cl. 1957).

n76 See Dolan v. Commissioner, 44 T.C. 420 (1965); Coerver v. Commissioner, 36 T.C. 252 (1961), aff'd per curiam, 297 F.2d 837 (3d Cir. 1962); Rev. Rul. 74-611, 1974-2 C.B. 399 (stating that filing a joint return does not convert separate property into a joint asset of the couple).

n77 *Maragon*, supra note 76, at 366. A different result may occur in the year of death. See J.R. Kemper, Annotation, Right of Surviving Spouse to Tax Refund Resulting from Joint Income Tax Return, 67 A.L.R.3d 1038 (1994). Several Pennsylvania cases have held that the surviving spouse is entitled to the full joint refund because a tenancy by the entireties was intended even though virtually the entire withholding was paid by the decedent. See also In re Green's Estate, 14 Pa. D. & C.2d 595 (1958); In re MacNeill's Estate, 21 Pa. D. & C.2d 480 (1959).

n78 I.R.C. § 151(b) provides that a taxpayer may claim an exemption for a spouse only if the spouse has no income and is not the dependent of another taxpayer. If a spouse has any income, an exemption for the spouse can not be claimed on a separate return. A can only "receive" an exemption for a spouse who has income if a joint return is filed. In that case, since each spouse is a taxpayer and each spouse receives his or her own exemption, A does not receive two exemptions.

n79 The tax liability is calculated as follows:

	MFS - 1 Exemption	MFS - 2 Exemptions	Joint Return
Income:	$ 90,000	$ 90,000	$ 90,000
Less:			
Personal Exemptions *	(2,300)	(4,600)	(5,000)
Standard Deduction	(3,275)	(3,275)	(6,550)
Taxable Income	$ 84,425	$ 82,125	$ 78,450
Tax	$ 22,854	$ 22,026	$ 16,896

* Subject to the personal exemption phase out beginning at adjusted gross income of $ 86,025 for married filing separately. I.R.C. § 151(d)(3)(C).

n80 A's allocation would be calculated as follows:

$ 0 (a's separate tax)/($ 0 + $ 21,184) (A's + B's separate tax) x $ 0 (joint tax) = $ 0

B's allocation would be calculated as follows:

$ 21,184 (B's separate tax)/($ 0 + $ 21,184) (A's + B's separate tax) x $ 0 (joint tax) = $ 0

n81 I.R.C. § 172.

n82 B's separate tax liability is $ 22,854. This is based on taxable income of $ 84,425 ($ 90,000 minus a standard deduction and one personal exemption).

n83 Treas. Reg. § 1.1502-33(d)(providing for an intra-company allocation of the "bonus" which is similar to Treas. Reg. § 20.2053-6(f)).

n84 Treas. Reg. § 1.1502-33(d)(6), Example (1).

n85 Treas. Reg. § 1.1502-33(d)(6), Example (2).

n86 I.R.C. § 63.

n87 I.R.C. § 63(b)(2)(A)-(D). In addition, the standard deduction is increased by a different amount if the taxpayer is 65 years of age or older or is legally blind depending on whether the taxpayer is single or married. I.R.C. § 63(f).

n88 I.R.C. §§ 1(a)-(d).

n89 Id. A taxpayer meeting several conditions can file as surviving spouse for two years following the death of his or her spouse. I.R.C. § 2(a). The effect of this status is to provide the surviving spouse with the same tax rates as married filing joint taxpayers, but with one less personal exemption.

n90 Rev. Rul. 80-7, 1980-1 C.B. 296. The ruling states that the separate tax liability of each spouse is "$ 10,302 and . . . $ 3,334, if the tax is calculated in accordance with section 1(d) of the Code." Section 1(d) is the tax rate for married filing separate. By using the word "if", is the Revenue Ruling implying that other provisions, such as 1(b) for head of household, may be appropriate?

n91 It is possible for a separated married taxpayer to file as single or head of household. If a married taxpayer furnishes over one-half the support and pays over one-half the cost of maintaining the household and during the last 6 months of the year is not a member of the same household as their spouse, the taxpayer will be treated as unmarried and thus either single or head of household for income tax purposes. I.R.C. § 7703(b). This is often referred to as an abandoned spouse.

Even if a spouse qualifies for head of household status, it should not be used for calculating the separate tax of the qualified spouse

because, in almost all cases where it applies, the couple will have a lower combined tax if the qualified taxpayer files as head of household. In that case, a joint return will not be filed and there will be no joint tax liability to allocate.

An example illustrates why a joint return would not be filed. Assuming that A and B are married and that A has a child and qualifies as head of household, the separate taxes of A and B are:

Taxpayer	A	B	A and B
Status	H.H.	MFS	Joint
Exemptions	2	1	3
Income	$ 30,000	$ 60,000	$ 90,000
Taxable income	$ 19,250	$ 54,225	$ 75,950
Tax	$ 2,888	$ 12,861	$ 16,196

Thus, the combined income tax is $ 15,749, almost $ 450 less than married filing a joint return. Note, that the $ 16,896 tax normally reported with $ 90,000 of joint gross income is only $ 16,196 due to the additional personal exemption.

If A instead has the higher income, the results are:

Taxpayer	A	B	A and B
Status	H.H.	MFS	Joint
Exemptions	2	1	3
Income	$ 60,000	$ 30,000	$ 90,000
Taxable income	$ 49,250	$ 24,225	$ 75,950
Tax	$ 9,728	$ 4,248	$ 16,196

Thus, the combined income tax is $ 13,976, almost $ 2,220 less than married filing a joint return.

n92 Rev. Rul. 80-7, 1980-1 C.B. 296.

n93 In 1995, the effect of denying the personal exemption is to overstate taxable income by $ 2,500 per exemption.

n94 Exemptions become irrelevant for high income taxpayers because under I.R.C. § 151(d)(3), the personal and dependency exemptions begin to phase out when joint adjusted gross income reaches $ 150,000.

n95 The 39.6% maximum marginal tax rate was not included because the exemption has generally been phased out prior to reaching the 39.6% marginal tax bracket.

n96 I.R.C. § 151(b) provides that one exemption is given to each taxpayer on a joint return.

n97 I.R.C. § 152(e)(1).

n98 I.R.C. § 152(e)(2). It is interesting that in the case of divorced (as compared to unmarried parents) the dependency exemption follows custody, not support. I.R.C. § 152(e)(1).

n99 In Jones v. Commissioner, 38 T.C.M. (CCH) 599 (1979), both parents claimed the same child as a dependent on separate returns. Under Texas community property law, they each contributed one-half of the child's support. Id. at 601. Since neither taxpayer contributed more than one-half the support, neither was entitled to the dependency exemption on a separate return. Id.

Where each spouse provides exactly half the support, the Service has ruled that the exemption may not be divided between the parents if they do not file a joint return. Priv. Ltr. Rul. 81-22-012 (Feb. 20, 1981).

n100 Dear Abby, Ann Landers, Dr. Joyce Brothers, Oprah, and King Solomon, were he alive today, probably would be astounded to find that a happily married couple is forced to allocate their child's exemption in the name of allocating their respective tax liabilities.

A similar all-or-nothing allocation frequently occurs as part of a divorce settlement, where the child's exemption can be given to either spouse by written agreement under I.R.C. § 152(e)(2). It is also common for siblings to agree in writing to allocate the exemption for their parents. I.R.C. § 152(c)(4).

n101 It is clear that most computer tax programs will not allow a taxpayer to claim one-half of a dependent. In such case, the practical solution is either to give each spouse a full exemption for the child or to not give an exemption to either parent. Either solution results in an inaccurate separate tax liability. If the couple has an even number of children, the exemptions can be properly split.

n102 Even if B provides 100% of the support of A's child, the exemption is given to A for tax purposes. I.R.C. § 152(e)(5).

n103 I.R.C. § 152(a)(9). The listed relatives include (step)children, (step)brothers, (step)sisters, (step)fathers, (step)mothers, uncles and aunts, nieces and nephews, grandchildren and grandparents, and various in-laws. I.R.C. §§ 152(a)(1)-(8).

n104 See, e.g., Johnson v. Commissioner, 39 T.C.M. (CCH) 868, 873 (1980); Finney v. Commissioner, 35 T.C.M. (CCH) 1504, 1506-07 (1976); Jolson v. Commissioner, 3 T.C. 1184, 1186-87 (1944). See also George E. Ray, Proposed Changes in Federal Income Taxation of Community Property: Income Tax, 30 Cal. L. Rev. 397, 404 (1940).

n105 I.R.C. § 1211(b)(1).

n106 Id.

n107 If B also has a capital loss, the joint loss of $ 3,000 should be allocated to A and B.

n108 When B's income is included, A's deductible capital loss is increased from $ 1,500 on a separate return, to $ 3,000 on a joint return plus the amount of net capital gains reported by B. I.R.C. § 1211(b)(2).

n109 I.R.C. § 165(h)(2).

n110 These are their gross casualty losses after reduction of $ 100 each under I.R.C. § 165(h)(1).

n111 I.R.C. § 165(h)(2).

n112 The loss would be allocated based on relative total loss as follows:

A = ($ 8,000 / $ 11,000) x $ 2,000 = $ 1,455

B = ($ 3,000 / $ 11,000) x $ 2,000 = $ 545

n113 I.R.C. § 86(c). If the spouses live apart the entire year, then the zero amount generally applicable to married taxpayers filing separately is itself not applicable and the $ 25,000 limit applies. I.R.C. § 86(c)(1)(A).

n114 I.R.C. § 86(c).

n115 Suppose A's only income is $ 12,000 in social security benefits and B has $ 50,000 in wages. If A's income is not recalculated to reflect the inclusion of a portion of the social security benefits, A would have no separate tax liability and B would bear the entire tax penalty.

A slight change of facts demonstrates why the joint statutory limitations as well as the joint return amounts should be used. If A's only income is $ 12,000 in social security benefits and B has $ 15,000 in wages, on a separate return basis, A's benefits would be taxable. On a joint return basis using the joint return limitations however, none of A's benefits would be taxable and a recalculation would not be required. I.R.C. § 86(c)(1)(B).

n116 Under I.R.C. § 135(b)(2)(A), the limits are $ 40,000 for a single return, $ 30,000 for married filing separately, and $ 60,000 for a joint return.

n117 I.R.C. § 111.

n118 Suppose, for example, that a $ 250 deduction is taken for an auto license purchased in October on A's car and a $ 350 deduction is taken for a license on B's car. Now assume A's car was sold in January and a refund of $ 200 was received. Since the $ 200 taxable refund is specifically identifiable as A's refund, it should be allocated to A.

n119 I.R.C. § 179(b)(1). Alternatively, this property is subject to the modified accelerated cost recovery system of sections 167 and 168 of the Code (MACRS property).

n120 I.R.C. § 179(b)(4).

n121 I.R.C. § 179(b)(2).

n122 There does not appear to be any authority on this issue. However, if A and B were to prorate the deduction on a separate return basis in a manner inconsistent with the joint return, and if A and B ever filed separate returns, A would lose the ability to depreciate amounts previously expensed on the joint return, and B would be permitted depreciation deductions on amounts already deducted on a separate return basis.

n123 I.R.C. §§ 1041(a)-(b). See Michael Asimow, The Assault on Tax-Free Divorce: Carryover Basis and Assignment of Income, 44 Tax L. Rev. 65, 66 (1988)(arguing the assignment of carryover basis is superior to other options in a tax-free divorce system).

n124 Temp. Treas. Reg. § 1.1041-1T(a), Example (1).

n125 Temp. Treas. Reg. § 1.1041-1T(a), Example (2) indicates that if A's sole proprietorship "makes a sale of property to B," it is treated as a gift if a separate return is filed. The effect would be to transfer the computer to A at the lower of its cost or fair market value. I.R.C. §

1015(e).

n126 I.R.C. § 1015(e).

n127 The only solution to this disappearing basis is for A to avoid purchasing business property from B. Interspousal allocation should not be used to circumvent established tax principals, even if they appear to be economically unjustified.

n128 Temp. Treas. Reg. § 1.1041-1T(a), A-4.

n129 The receipt of personal service income may also increase B's self-employment tax.

n130 1974-1 C.B. 46.

n131 I.R.C. § 1041, which disallows gain or loss on the "transfer of property" between spouses, became effective after July 18, 1984. Pub. L. No. 98-369, § 421(d), 98 Stat. 494, 793.

n132 Temp. Treas. Reg. § 1.1041-1T(a), A-4.

n133 I.R.C. § 219(g)(3)(B)(i).

n134 I.R.C. § 219(g)(3)(B)(iii).

n135 I.R.C. § 219(c)(2)(A)(i).

n136 Rev. Rul. 55-479, 1955-2 C.B. 57.

n137 Rev. Rul. 59-66, 1959-1 C.B. 60.

n138 Id.

n139 Rev. Rul. 55-479, 1955-2 C.B. 57; see also Stewart v. Commissioner, 35 B.T.A. 406, 411, (1937), aff'd. 95 F. 2d 821 (5th Cir. 1938) (applying the same proposition to charitable contributions).

n140 I.R.C. § 213(a).

n141 I.R.C. § 67.

n142 I.R.C. § 165(h)(2). The $ 100 per event reduction could also come into play, since if the family home is robbed, only one $ 100 limit is imposed on a joint return, whereas if the couple are just roommates, each must reduce their loss by $ 100. I.R.C. § 165(h)(1).

n143 Rev. Rul. 75-347, 1975-2 C.B. 70.

n144 I.T. 3304, 1939-2 C.B. 158. This ruling was reversed based on the theory that the casualty loss provided in I.R.C. § 165 arises not from the repair, but from the loss, which is sustained by both owners, regardless of who makes the repairs. Rev. Rul. 75-347, 1975-2 C.B. 70.

n145 I.R.C. § 1012.

n146 I.R.C. § 170(b)(1).

n147 I.R.C. § 170(d).

n148 Treas. Reg. § 1.170A-10(d)(4)(b) states in part that in calculating each spouse's share of the joint charitable deduction,

> . . . a computation shall be made of the amount of any excess charitable contribution which each spouse would have computed . . . if separate returns (rather than a joint return) had been filed for the contribution year. The portion of the total unused excess charitable contribution for the contribution year allocated to each spouse shall be an amount which bears the same ratio to such unused excess charitable contribution as such spouse's excess contribution, based on the separate return computation, bears to the total excess contributions of both spouses, based on the separate return computation. . . .

n149 Treas. Reg. § 1.170A-10(e).

n150 I.R.C. § 170(b)(1)(B).

n151 This would apparently be the case even if A's AGI is only $ 30,000; this places A into the position of transferring the $ 20,000 excess deductions to B by way of a carryover of B's 30% contribution. In addition, this allocation is unfair to B who, if unmarried, would receive a charitable contribution equal to 30% of B's AGI; however, according to Rev. Rul. 76-267, 1976-2 C.B. 71, the spouses may not allocate the carryover by agreement, but they must allocate the carryover based on Treasury Reg. § 1.170A-10. They could, however, make non-taxable gifts to each other under I.R.C. § 1041 prior to making the charitable contribution. In that case, they could each donate a portion of cash and stock.

n152 I.R.C. § 163(h)(4)(A)(ii). In order for a married person to qualify for two residences on a separate return, the taxpayer's spouse must consent in writing for the taxpayer to claim "the principal residence plus 1 other residence." I.R.C. § 163(h)(4)(A)(ii)(II).

n153 I.R.C. § 163(h)(3)(B)(ii). The same is true for the $ 100,000 home equity indebtedness which is reduced to $ 50,000 on a separate return. I.R.C. § 163(h)(3)(C)(ii).

n154 The joint return would be calculated as:

A's interest, $ 400,000 x 6% = $ 24,000

B's interest, $ 600,000 x 10% = 60,000

Total interest deducted $ 84,000

The effect of the phase out of itemized deductions and the ability to deduct interest on an additional $ 100,000 of home equity indebtedness under I.R.C. § 163(h)(3)(C) has been excluded in order to simplify the example.

n155 An allocation based on relative interest payments appears as follows:

	A	B	Joint
Allocation Formula			
(A $ 900,000 [at] 6%)			
(B $ 600,000 [at] 10%)	$ 54,000	$ 60,000	$ 114,000
Joint deduction:			$ 84,000
Interest allocation			
(54 / 114 and 60 / 114)	$ 39,789	$ 44,211	$ 84,000

An allocation based on relative principal appears as follows:

	A	B	Joint
Allocation Formula			
(relative principal)	$ 900,000	$ 600,000	$ 1,500,000
Joint deduction:			$ 84,000
Interest allocation			
(90 / 150 and 60 / 150)	$ 50,400	$ 33,600	$ 84,000

The problem with allocating based on either relative total interest payments or relative total principal is that both methods distort A's deduction by failing to take into account the $ 500,000 limit on a separate return basis.

The distortion becomes even more apparent when A and B both have 6% loans, but A has a $ 1,000,000 loan and B has a $ 500,000 loan. Should A be allocated 2/3 of the deduction and B only be allocated 1/3 based on their relative interest payments or relative principal amounts? Such a method would circumvent the purpose of interest expense limitations enacted by Congress.

n156 I.R.C. § 163(d).

n157 I.R.C. § 163(d)(4)(C).

n158 I.R.C. § 163(d)(2).

n159 I.R.C. § 1211(b)(1). The limitation is $ 1,500 for married persons filing a separate return.

n160 I.R.C. § 1212(b).

n161 I.R.C. § 1212(b)(1).

n162 I.R.C. § 1211(b)(1). See also Treas. Reg. § 1.1212-1(c)(2), Example 2.

n163 I.R.C. § 1212(b)(2)(A).

n164 I.R.C. § 1231(a)(1).

n165 I.R.C. § 1(h).

n166 I.R.C. § 1231(c). In fact, neither the Code nor the regulations address whether the recapture provisions apply separately or on a joint return basis. Thus, it may be possible to avoid the affect of the I.R.C. § 1231 recapture of "spousal" net ordinary loss if separate returns are filed.

n167 The allocation was calculated as follows:

A = $ 25,722 x $ 12,648 / ($ 12,648 + $ 12,861) = $ 12,754

B = $ 25,722 x $ 12,861 / ($ 12,648 + $ 12,861) = $ 12,968

n168 The difference is much larger if the couple's marginal income is subject to tax at 39.6% rather than the 31% in this example.

n169 I.R.C. §§ 170(b)(1)(A)(i)-(ii).

n170 Treas. Reg. § 1.172-7(d).

n171 I.R.C. §§ 172(d)(3)-(4) and Treas. Reg. § 1.172-3(d).

n172 Treas. Reg. § 1.172-7(d)(1).

n173 Treas. Reg. § 1.172-7(g), Example (1).

n174 Id.

n175 The same allocation is necessary if the loss is carried forward to a year in which the couple is no longer married.

n176 Rev. Rul. 60-216, 1960-1 C.B. 126; Rev. Rul. 74-611, 1974-2 C.B. 399.

n177 Rev. Rul. 74-611, supra note 176. See Zeeman v. United States, 275 F.Supp. 235, 253-54 (S.D.N.Y. 1967) aff'd 395 F.2d 861 (2d Cir. 1968) for a case where a widow unsuccessfully attempted to carry over losses of her deceased husband. See also Timothy A. Murphy, How to Handle an NOL Carryback After a Divorce, 18 Prac. Acct. 89 (1985).

n178 In most cases, only A's separate tax will be affected. Unfortunately, if the couple claimed itemized deductions in the carryback year which were subject to reduction based on adjusted gross income or if C received taxable social security benefits, C's separate tax liability also will have to be recomputed since the carryback of A's loss reduces adjusted gross income. The effect is to increase many itemized deductions and possibly reduce the taxation of social security benefits.

n179 Rev. Rul. 86-57, 1986-1 C.B. 362. The Service provides detailed instructions on the effect of changes of marital status on filing net operating loss carrybacks or carryforwards in IRS Pub. No. 536, Net Operating Losses (1994).

n180 Although the general rule is that both spouses must sign a joint return, a separate refund claim was allowed by a surviving spouse on the amended joint return even though the other taxpayer (in this case the estate of the deceased spouse) did not join in the refund suit. Pettengill v. United States, 253 F.Supp. 321 (DC Il. 1966). See also Rev. Rul. 80-8, 1980-1 C.B. 298, which specifically allows one spouse to sign the amended joint return.

n181 Rev. Rul. 86-57, supra note 179. It does not appear that either A or the I.R.S. has any obligation to notify C that he or she is entitled to a refund which can be claimed simply by filing an amended return which shows A's net operating loss carryback plus the new allocation of the lower amended joint tax liability.

n182 It is unclear whether the rule should apply if A's loss is a carryover. For example, if A had a net operating loss carryforward rather than a passive activity loss carryforward, Rev. Rul. 74-611, 1974-1 C.B. 399, and Rev. Rul. 60-216, 1960-1 C.B. 126, state that A can not offset a net operating loss carryover against B's current year income. Are similar rules not applicable to passive loss carryovers?

n183 Temp. Treas. Reg. § 1.469-1T(j).

n184 I.R.C. § 469(i).

n185 Treas. Reg. § 1.469-1T(j)(3).

n186 Treas. Reg. § 1.469-1T(j)(2)(i).

n187 I.R.C. § 121.

n188 I.R.C. § 121(b)(2). The only exception appears to be if the sale is made prior to marriage. Treas. Reg. § 1.121-2(b)(2), Examples (1)-(3).

n189 Priv. Ltr. Rul. 89-09-020 (Dec. 2, 1988). The $ 125,000 exclusion may be the largest single example of the marriage penalty since if two single taxpayers jointly own the same residence, they can each exclude $ 125,000 if they separately meet the statutory requirements. In the case of a married couple, the same $ 125,000 exclusion applies to the couple.

n190 This is a marriage bonus, because if the couple were not married, the under 55 year-old spouse could not exclude any gain.

n191 If this were not the case, the younger spouse will never receive the tax benefit of the exclusion.

n192 I.R.C. § 121(c).

n193 B may not have received any of the savings if B was married to C at the time of the sale and the gain related to the sale of C's residence. In that case only C received the benefit from the exclusion.

n194 I.R.C. § 121(c).

n195 I.R.C. § 151(d)(3). In the case of married filing separately, the phase-out begins at $ 86,025 and it is based on 2 percent of each $ 1,250 increment. For single taxpayers, the phase-out begins at $ 114,700. Thus, two single taxpayers can report a total of $ 229,400 of adjusted gross income without being subject to the phase-out while a married couple would have already lost 46 percent of their exemptions. The calculation is:

Amount subject to phase-out:	$ 229,400 - $ 172,050 = $ 57,350.
Phase-out:	$ 57,350 / 2,500 = 22.94
Phase-out:	23 (rounded to next highest) x 2% = 46%.

The effect on a married couple with no dependents would be the reporting of $ 2,300 additional taxable income, which is two personal exemptions at $ 5,000 times 43%. Assuming a 36% tax rate, the phase-out results in a marriage penalty of $ 828.

n196 I.R.C. § 68. The level is $ 57,350 for married filing separately. Thus, two single taxpayers do not lose any itemized deductions until they separately have over $ 114,700 of adjusted gross income, the same amount applicable to a joint return. This could result in a married couple with combined adjusted gross income of $ 229,400 reporting $ 3,441 more income than two single taxpayers: three percent of $ 114,700. At the 36% tax bracket, this would cause the married couple to pay a penalty of $ 1,239.

n197 Although this is inconsistent with the treatment of income and deductions which must be recalculated based on the amounts reported on the joint return, that policy is not designed to make the combined separate taxable incomes of the spouses equal the joint taxable income. The purpose of the recalculation is to guarantee that the spouse who earns income, or makes a deductible payment, pays tax on an amount of income that is reported on the joint return. If a similar policy were used in the context of phaseouts, the joint phaseouts should be allocated based on the relative adjusted gross incomes and deductions of the spouses.

n198 Moreover, in the context of the itemized deduction phase out, what happens if the 80 percent limit applies only on a separate return basis?

n199 Treas. Reg. § 1.31-1(a); Rev. Rul. 80-7, 1980-1 C.B. 296 (stating that "each spouse's contribution will include the withholding tax credits reported by the spouse on the joint return.").

n200 Rev. Rul. 80-7, supra note 199, at 297.

n201 Morris v. Commissioner, 25 T.C.M. (CCH) 1248, 1255 (1966).

n202 Treas. Reg. § 1.6015(b)-1(b) provides that the fact that a joint declaration of estimated tax is made does not prevent the filing of separate returns.

n203 Treas. Reg. § 1.6015(b)-1(b). Treas. Reg. § 1.6654-2(e) states, "For rules with respect to the allocation of joint payments of estimated tax, see I.R.C. § 6015(b) and regulation § 1.6015(b)-1(b)."

n204 Rev. Rul. 80-7, supra note 199. Treas. Reg. § 1.6015(b)-1(b) reads in pertinent part:

> In the event the husband and wife fail to agree to a division, such payments shall be allocated between them in accordance with the following rule. The portion of such payments to be allocated to a spouse shall be that portion of the aggregate of all such payments as the amount of tax imposed by chapter 1 (other than by section 56) shown on the separate return of the taxpayer . . . bears to the sum of the taxes . . . shown on the separate returns of the taxpayer and his spouse . . . .

See also Johnson v. United States, 386 F.Supp. 319 (D. Minn. 1974).

n205 In Wells v. Commissioner, 22 T.C.M. (CCH) 169 (1963), the joint estimated tax payment was made by the husband and the court allocated the payment evenly, since there was no evidence to indicate that the couple did not agree to divide the estimated tax evenly.

Further, Rev. Rul. 76-140, 1976-1 C.B. 376, provides an indication of extrinsic evidence of an agreement to share the estimated taxes other than evenly. It holds that if A and B file a joint return and apply an overpayment to the subsequent year, and if A claims the entire overpayment and B claims none of it on their separate returns the following year, then that is evidence of an agreement to allocate the tax entirely to A.

In Gooding v. Commissioner, 27 T.C. 627 (1956), joint estimated tax payments made by a former spouse were not credited to the taxpayer, since the taxpayer had no knowledge of the payment.

n206 I.R.C. § 6654(d)(1)(B)(ii).

n207 I.R.C. § 6402(b).

n208 Treas. Reg. § 1.6654-2(e).

n209 Although the methodology is the same as that used in Treas. Reg. § 20.2053-6(f), that provision is not cited.

n210 In most cases, if the taxpayers hire an accountant to prepare their return, the cost of preparing all of the required joint and separate estimated tax penalty calculations will far exceed the potential benefit to either spouse. A simple estimated calculation, although not accurate, may prove to be more cost effective.

n211 I.R.C. § 55(d)(1).

n212 I.R.C. § 55(d)(3).

n213 Allocations similar to the one listed above must be made if the joint return is subject to an alternative minimum tax net operating loss or an alternative minimum tax credit carryforward under I.R.C. § 55(c), which simply states that the minimum tax credit can not exceed the "regular tax liability for the taxable year."

n214 I.R.C. §§ 31(b)(1) and 6413(c).

n215 I.R.C. §§ 1401(a)-(b).

n216 I.R.C. § 164(f)(2).

n217 A's income tax liability is calculated as follows:

$ 16,896 x $ 12,861 / ($ 12,861 + $ 4,248) = $ 12,701

n218 B's income tax liability is calculated as follows:

$ 16,896 x $ 4,248 / ($ 12,861 + $ 4,248) = $ 4,195

n219 Treas. Reg. §§ 1.904-3(e)(1)-(3).

n220 I.R.C. § 32(d). Unfortunately, the earned income tax credit creates a very large marriage penalty. See John Brozovsky, A Component Analysis of the Marriage Tax Penalty, 69 Tax Notes 1409, 1410 (Dec. 11, 1995).

n221 1987-1 C.B. 347. The ruling provides in pertinent part:

> The allocated amount is arrived at by using the Earned Income Credit Tables to determine the hypothetical separate earned income credit that would have been available to each spouse if that spouse had filed a separate return (and if the earned income credit were available on a separate return) and then using the following formula:

Spouses contribution to earned income credit =

$$\frac{\text{Spouses hypothetical separate earned income credit}}{\text{Sum of the hypothetical separate earned income credits for the two spouses.}} \text{ x } \text{Joint earned income credit (from joint return)}$$

n222 1967-2 C.B. 411.

n223 I.R.C. § 72(q).