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TAXES AND MARITAL SITUATIONS

A person's marital status may affect both the calculation of income tax owed and Internal Revenue Service actions to collect any unpaid taxes. Two concepts that may affect people in special circumstances are "joint liability" and "community property." In 1996, the IRS began a study on how these concepts affect taxpayers, especially those who are divorced or separated, and invited public comment on proposals addressing specific issues. The resulting report is under final review at the Treasury Department.

Joint and Several Liability

The tax law allows a married couple to file a joint income tax return, even though one spouse may not have any income or deductions. The law also makes each spouse on a joint return fully liable for any taxes owed. Even if they later separate and/or divorce, they each remain liable for any taxes, interest or penalties arising from the joint returns they filed while married. This liability remains regardless of any divorce decree or separation agreement.

For example, if a couple divorced and the IRS assessed more tax after auditing a joint return the couple had previously filed, each person would be held liable for the unpaid tax and related interest. The IRS could enforce collection against either spouse's assets, even if that person had subsequently remarried. Under the tax law, not even a written agreement in which one person took responsibility for any taxes owed would relieve the other spouse of the obligation to pay.

Since the IRS can collect unpaid taxes from either person on a joint return, one spouse might pay taxes without knowing what, if any, collection activity was under way against the other person. The IRS established uniform procedures in 1996 to notify one spouse of activity against the other while safeguarding the privacy rights of both. The Taxpayer Bill of Rights II later made this a requirement of law.

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Innocent Spouse Relief

There could be times when it would be unfair to collect from one spouse taxes that resulted solely from the other spouse's actions. Recognizing this, Congress in 1971 set four conditions for relieving one spouse of liability for a joint return. All of the conditions must be met for this "innocent spouse" relief to apply.

These conditions are:

-- the spouses filed a joint return;
-- this return substantially understated the tax because of a grossly erroneous item of one spouse;
-- the other spouse did not know, and had no reason to know, of this understatement; and
-- taking all the facts and circumstances into account, it would be unfair to hold the other spouse liable for the additional tax.

The law further specifies the amounts by which the understatement of tax must exceed the person's income. Many people seeking innocent spouse relief have been unable to satisfy all the elements required under the law. For example, a person may meet all the other conditions, but the tax understatement falls below the necessary level. Or a wife may not be able to demonstrate that she had no reason to know that her husband substantially understated the tax when he prepared the return. In some situations, the IRS may determine different tax liability amounts for the husband and for the wife, even after a joint return has been filed.

Community Property Laws

Ten states -- Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin -- have community property laws, which may present special tax considerations for some people. Community property laws generally consider each spouse to own one-half of their community income.

A couple's community property is everything they acquire during their marriage while they are domiciled in a community property state. There are certain exceptions for gifts or inheritances received, as well as for property bought with separate funds. According to state law, each spouse owns half the community property. For example, each spouse owns half of the wages earned by the other. Any property which cannot be identified as separate property is considered community property.

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The classification of property under state laws determines its status for federal tax purposes. Thus, even if a married couple in a community property state file separate tax returns, they must each report half of the total community income, including half of each other's wages. The law provides certain exceptions for those who live apart for the whole year and do not transfer any earned income between them. Special rules also apply to those filing separately who did not know of an item of community income, if it would be unfair to include the income on that person's return.

Community property laws may also affect the treatment of assets which the IRS may collect to satisfy an unpaid tax liability. All or a portion of the community property may be used to satisfy a separate tax obligation of one spouse, even if the tax arose before they were married. For example, suppose a woman divorces, remarries, and now lives in a community property state, and there are unpaid taxes from the last joint return she filed with her first husband. The IRS may levy her wages and the wages of her second husband, since -- under community property laws -- she owns half of his income.

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