



MANUAL TRANSMITTAL

Department of the Treasury
Internal Revenue Service

25.18.2

JULY 28, 2021

EFFECTIVE DATE

(07-28-2021)

PURPOSE

- (1) This transmits revised IRM 25.18.2, Community Property, Income Reporting Considerations of Community Property.

MATERIAL CHANGES

- (1) Significant changes to this IRM are reflected in the table below.

IRM Reference	Description of Change
IRM 25.18.2.9	Updated to incorporate applicable content from Interim Guidance Memorandum SBSE-04-0719-0034, Interim Guidance on Third-Party Contact Notification Procedures, dated July 26, 2019.
Exhibit 25.18.2-1	Edited tables to comply with 508 requirements.

- (2) Reviewed and updated legal references, IRM references and made minor editorial changes, as necessary.

EFFECT ON OTHER DOCUMENTS

This material supersedes IRM 25.18.2 dated February 23, 2018. This IRM incorporates applicable content from Interim Guidance Memorandum SBSE-04-0719-0034, Interim Guidance on Third-Party Contact notification Procedures, dated July 26, 2019.

AUDIENCE

This IRM section is intended to address the needs of all Service employees who are working on cases involving taxpayers domiciled in community property states, or cases otherwise raising community property issues.

Lori L. Caskey
Director, Examination–Field and Campus Policy
Small Business/Self-Employed
SE:S:DCE:E:HQ:EFCP

25.18.2

Income Reporting Considerations of Community Property

Table of Contents

25.18.2.1 Program Scope and Objectives

25.18.2.1.1 Background

25.18.2.1.2 Authority

25.18.2.1.3 Responsibilities

25.18.2.1.4 Terms

25.18.2.1.5 Acronyms

25.18.2.1.6 Related Resources

25.18.2.2 Income Reporting Considerations of Community Property

25.18.2.3 IRC 66

25.18.2.3.1 General Provisions of IRC 66

25.18.2.3.1.1 IRC 66(a) - Treatment of Community Income Where Spouses Live Apart

25.18.2.3.1.2 IRC 66(b) - Denial of Community Property Benefits Where Spouse Not Notified

25.18.2.4 Self-Employment Tax

25.18.2.5 Claiming of Deductions

25.18.2.6 Alimony or Separate Maintenance

25.18.2.7 Claiming of Credits

25.18.2.8 Disclosure Considerations

25.18.2.9 Third-Party Contacts

25.18.2.10 Statutory Notice Considerations for Community Property Adjustments to Income

25.18.2.11 Bureau of Labor Statistics

25.18.2.12 Classification of Community Property Limited Liability Companies

Exhibits

25.18.2-1 IRC 66(a) and IRC 66(b) Pro Forma Check sheets for Examiners

25.18.2.1
(02-23-2018)
Program Scope and Objectives

- (1) **Purpose.** This IRM provides technical guidance regarding income reporting considerations in community property states, or cases otherwise raising community property issues.
- (2) **Audience.** This guidance applies to all Service employees working cases involving income reporting considerations in community property states, or cases otherwise raising community property issues.
- (3) **Policy Owner.** The Director, Examination - Field and Campus Policy, who is under the Director, Headquarters Examination.
- (4) **Program Owner.** Field Examination General Processes (FEGP), which is under the Director, Examination - Field and Campus Policy.
- (5) **Contact Information.** To recommend changes or make any other suggestions related to this IRM section, see IRM 1.11.6.6, Providing Feedback About an IRM Section - Outside of Clearance.

25.18.2.1.1
(02-23-2018)
Background

- (1) This IRM provides information regarding income reporting considerations of community property.

25.18.2.1.2
(02-23-2018)
Authority

- (1) Federal law determines how property is taxed, but state law determines whether, and to what extent, a taxpayer has “property” or “rights to property” subject to taxation. *Aquilino v. United States*, 363 U.S. 509 (1960); *Morgan v. Commissioner*, 309 U.S. 78 (1940). Accordingly, federal tax is assessed and collected based upon a taxpayer’s state created rights and interest in property. Additional information can be found, but is not limited to, the following IRC and Code of Federal Regulations (CFR) sections:
 - IRC 66, Treatment of community income
 - 26 CFR 1.66-1, Treatment of community income
 - 26 CFR 1.66-2, Treatment of community income where spouses live apart

25.18.2.1.3
(02-23-2018)
Responsibilities

- (1) The Director, Headquarters Examination, is the executive responsible for providing policy and guidance for SB/SE Examination employees and ensuring consistent application of policy, procedures and tax law to effect tax administration while protecting taxpayers’ rights. See IRM 1.1.16.3.5, Headquarters Examination, for additional information.
- (2) The Director, Examination - Field and Campus Policy (formerly known as the Director, Examination AUR/Policy), reports to the Director, Headquarters Examination, and is responsible for the delivery of policy and guidance that impacts the examination process. See IRM 1.1.16.3.5.1, Field and Campus Policy, for additional information.
- (3) Field Examination General Processes (FEGP), which is under the Director, Examination - Field and Campus Policy, is responsible for providing policy and procedural guidance on standard examination processes to field employees. See IRM 1.1.16.3.5.1.1, Examination-Field General Processes, for additional information.

- (4) Employees are responsible for properly applying community property rules and IRC 66 fairly and consistently.
- (5) Employees and their managers should thoroughly acquaint themselves with the information contained in this IRM, as well as other resources, such as those listed in IRM 25.18.2.1.6, Related Resources, below.

25.18.2.1.4
(02-23-2018)

- (1) The following table contains a list of terms used throughout this IRM:

Terms

Term	Definition
Community Property	Generally, defined as all property acquired during marriage that is not established to be separate property. Community property is the default characterization of all marital assets. See IRM 25.18.1.3.10, Definition of Community Property, for additional information.
Community Property Law	A property system where the presumption is that each spouse contributes income and assets to the “community” of the spouses, and shares equally in any earnings, assets, and debts of the community. See IRM 25.18.1.2.2, Community Property Law, for more information.
Community Property States	States that use community property law as their property system. Each state’s law can vary based on the individual state statutes. See IRM 25.18.1.2.2, Community Property Law, for more information.
Registered Domestic Partners	Individuals of the same sex and opposite sex who are in registered domestic partnerships, civil unions or other similar formal relationships that are not marriages under state law. Registered domestic partners (RDP) are not married for federal tax purposes. Therefore, they may not file “married filing jointly” or “married filing separately” federal income tax returns. See IRM 25.18.1.3.3, Registered Domestic Partners, for more information.
Separate Property	Generally all property acquired before the creation or after termination of the community property estate and property acquired by one spouse during marriage through gift, inheritance, or an award for personal injury damages. See IRM 25.15.5.5, Community and Separate Property, for additional guidance on property acquired by one spouse if purchased with separate funds and IRM 25.18.1.3.16, Sale or Exchange of Separate Property, for additional information on sale or exchange for separate property.

25.18.2.1.5
(02-23-2018)

- (1) The following table lists acronyms used in this IRM:

Acronyms

Acronyms	Definition
BLS	Bureau of Labor Statistics
IRA	Individual Retirement Arrangement
LLC	Limited Liability Company
RDP	Registered Domestic Partners

25.18.2.1.6
(02-23-2018)
Related Resources

- (1) The following IRMs provide additional information regarding community property:
 - IRM 25.18.1, Basic Principles of Community Property Law.
 - IRM 25.18.4, Collection of Taxes in Community Property States.
 - IRM 25.18.5, Injured Spouse.
 - IRM 25.15.5, Relief from Community Property Laws.
- (2) Helpful information can be found on the following website: *Community Property Website*.

25.18.2.2
(02-23-2018)
Income Reporting Considerations of Community Property

- (1) If joint returns are filed, there is little or no impact from reporting community property income. All income of both spouses is reported on the return. If separate returns are filed, each spouse reports half of each income item that is community property. *Poe v. Seaborn*, 282 U.S. 101 (1930). Income that is not community property is reported by the spouse who earned or accrued it.
- (2) Therefore, the characterization of income items will determine how they are reported. In the context of income items, the characterization rules are not always simple to apply. The following is a brief list of income items and their characterization. For additional information on the characterization of income see IRM 25.18.1, Basic Principles of Community Property Law.
 - a. **Earnings, wages and profits.** A spouse's wages, earnings and net profits from a sole proprietorship are community property and must be split.
 - b. **Partnership income.** If an interest is held in a partnership, and income from the partnership is attributable to the efforts of either spouse, the partnership income is community property. If it is merely a passive investment in a separate property partnership, the partnership income will be characterized in accordance with the discussion in subparagraph f, Income from Separate Property, below.
 - c. **Income Acquired Before Marriage or Community Property Domicile.** Separate property includes property acquired before the spouses were married, or during marriage but before both spouses domiciled in a community property state. Income received under these circumstances would be separate property and not community property.
 - d. **Income in Year of Divorce.** Income received in the year of divorce, but before dissolution, is community property and must be split. *Kimes v. Commissioner*, 55 T.C. 774 (1971). Generally, when spouses file a separate return for the year of divorce, an allocation must be made

between community property income and income earned after divorce. See subparagraph e, **Income After Death, Divorce, or Other Termination of Community Estate**, below.

- e. **Income After Death, Divorce, or Other Termination of Community Estate.** Income acquired after death, divorce, or some other termination of the community estate is not community property. States have different rules for determining when the community estate is terminated. See IRM 25.18.1.3.4, Termination of the Community Estate.
- f. **Income From Separate Property.** Whether income from separate property (e.g., dividends, interest, rents) is community property or separate property depends on the state involved. In some states, dividends, interest and rents from separate property are separate property. These states include Washington, Nevada, California, Arizona and New Mexico. Other states characterize interest, dividends and rents from separate property as community property. These states include Idaho, Louisiana, Wisconsin and Texas. See IRM 25.18.1.3.14, Income from Separate Property Received During Marriage.
- g. **Dividends, Interest and Rents from Community Property.** Dividends, interest and rents from community property are community property and must be split.
- h. **Illegal Income.** Income earned illegally is taxable. *James v. United States*, 366 U.S. 213 (1961); *Rutkin v. United States*, 343 U.S. 130 (1952). In community property states, property must be “acquired” by a spouse for it to become community property. The term “acquired” has been interpreted to mean the passage of title. Thus, if the payor or victim of the illegal income intended to pass title to the income to the spouse, it is community property income. If not, the income is separate property. *Johnson v. Commissioner*, 72 T.C. 340 (1979), acq. 1980-2 C.B. 1 (Texas law); *Berenbeim v. Commissioner*, T.C. Memo. 1992-272 (California law); *Hilton v. Commissioner*, T.C. Memo. 1990-379 (Louisiana law). For example, in *Johnson*, fraudulent tax refund checks paid in the name of the spouse are community property, while those paid in the names of third parties, which the spouse appropriated, are separate property. In *Berenbeim*, the court held that funds received under the guise that they would be invested, but that were later embezzled, are not community property because title did not pass under California law. The issue is most likely to appear in the context of a theft, embezzlement, or misappropriation and whether the income is community property will depend on state law. Illegal income from the sale of prohibited services or goods (e.g., drugs) is likely to be community income, because the payor intended to make the payment and pass title. See discussion in *Costa v. Commissioner*, T.C. Memo. 1990-572.
- i. **Capital Gains From Separate Property.** Generally, appreciation in value of separate property is also separate property, unless the appreciation in value is attributable to the labor of the non-owning spouse and not compensated by the owning spouse. For example, market appreciation on publicly traded stocks held as separate property is also separate property. If the increase in value is attributable to the skills of the non-owning spouse or to the application of community property to the separate property asset, a different result may occur depending on the facts and the applicable state law. See IRM 25.18.1.3.21, Capital Gains From Separate Property, and IRM 25.18.1.3.23, Mixing or Commingling Community Property With Separate Property.

- j. **Earned Income Credits, IRA withdrawals and related penalties, Railroad Retirement Benefits, Self Employment Tax, Social Security Benefits and US Savings Bonds.** These are by law deemed to be separate property. See IRM 25.18.1.3.28, Federal Preemption of State Community Property Characterization, for additional information. For example, taxable IRA distributions are separate property, even if the funds in the account would otherwise be community property. The withdrawal and any penalties are wholly taxable to the spouse whose name is on the account. *Bunney v. Commissioner*, 114 T.C. 259 (2000); *Morris v. Commissioner*, T.C. Memo. 2002-17.

- (3) Form 8958, Allocation of Tax Amounts Between Certain Individuals in Community Property States, is used to determine the allocation of tax amounts between married filing separate spouses or registered domestic partners (RDPs) with community property rights, as follows:

- Married Filing Separate Spouses - used by married spouses in community property states who choose to file married filing separately. This does not apply to spouses who meet the requirements of IRC 66(a). See IRM 25.18.2.3.1.1, IRC 66(a) - Treatment of Community Income Where Spouses Live Apart, for additional information.
- RDPs - used for RDPs who are domiciled in Nevada (NV), Washington (WA), or California (CA). For 2010 and following years, a RDP in NV, WA, or CA must follow each state's community property laws and report half of the combined community income of the individual and his or her registered domestic partner. See IRM 25.18.1.3.3, Registered Domestic Partners, for additional information.

25.18.2.3 (02-23-2018) IRC 66

- (1) The Supreme Court, in *Poe v. Seaborn*, 282 U.S. 101 (1930), held that spouses receiving income that is community property and filing separate returns are each required to report half of each community property income item. This case required a spouse to report half of community property income even if the spouse had not received or benefited from any of the income. Congress enacted IRC 66 to address this problem. See S. Rep. No. 96-1036, at 8 (1980). IRC 66 grants spouse's (or spouses') relief from the community property income splitting requirements in certain circumstances.

25.18.2.3.1 (02-23-2018) General Provisions of IRC 66

- (1) IRC 66 has three subsections that can affect the reporting of community property income as follows:
- a. IRC 66(a) provides an exception to the general rule of community property income splitting. See IRM 25.18.2.3.1.1, IRC 66(a) - Treatment of Community Income Where Spouses Live Apart, for additional information.
 - b. IRC 66(b) allows the Service to shift the incidents of taxation to the other spouse if certain requirements are met. See IRM 25.18.2.3.1.2, IRC 66(b) - Denial of Community Property Benefits Where Spouse Not Notified, for additional information.
 - c. IRC 66(c) grants relief to spouses from reporting half of particular items of community property income. See IRM 25.15.5.14, IRC 66(c) - Innocent Spouse Relief, for additional information.

- (2) IRC 66(c) applies only to community income, as defined by state law. Some of the requirements of the section can be quite complex.

25.18.2.3.1.1
(02-23-2018)

**IRC 66(a) - Treatment of
Community Income
Where Spouses Live
Apart**

- (1) Under IRC 66(a) if spouses meet certain requirements, they do not report most community property income under community property rules. IRC 66(a) provides an exception to the general rule that community income is taxed one half to each spouse domiciled in a community property state. This is a special rule that allocates earned income to the spouse who earned the income if certain statutory requirements are met. It applies where:

- a. The spouses are married to each other at any time during the calendar year,
- b. The spouses live apart at all times during the calendar year. For purposes of this requirement, living apart requires that spouses maintain separate residences,

Note: Spouses who maintain separate residences due to temporary absences are not considered to be living apart. See 26 CFR 1.66-2(b) for additional information. 26 CFR 1.66-2(d), Example 1.

- c. The spouses do not file a joint return with each other for the taxable year beginning or ending in the calendar year,
- d. One or both of the spouses have earned income for the calendar year, which is community income, and
- e. No portion of the earned income is transferred between the spouses, directly or indirectly, before the close of the calendar year. Transferred income does not include de minimis amounts of earned income transferred between spouses. Amounts transferred for the benefit of the spouses' child are not treated as direct or indirect transfers of income. Income transferred between spouses is presumed to be a transfer of earned income, although the presumption is rebuttable. See 26 CFR 1.66-2(c) for additional information.

- (2) If all of these criteria are met, spouses in community property states must report their income according to IRC 879(a), which provides:

- a. Earned income (within the meaning of IRC 911(d)(2)), other than trade or business income and a partner's distributive share of partnership income, shall be treated as the income of the spouse who rendered the personal services.
- b. Trade or business income is taxed to the spouse who owns the business unless the other spouse exercised substantially all of the management and control of the business, in which case it is treated as the other spouse's income. See IRC 879(a)(2) and IRC 1402(a)(5).
- c. A distributive share from a partnership is taxed to the spouse who is the partner. See IRC 879(a)(2) and IRC 1402(a)(5).
- d. Income derived from the separate property of one spouse is taxed to that spouse. See IRC 879(a)(3).
- e. All other forms of income are taxed in accordance with normal community property laws. See IRC 879(a)(4). This includes dividend, interest, rents, royalties, capital gains, and earnings of unemancipated minor children.

25.18.2.3.1.2
(02-23-2018)

IRC 66(b) - Denial of Community Property Benefits Where Spouse Not Notified

- (1) IRC 66(b) provides an exception to the general rule that community income is taxed one-half to each spouse. IRC 66(b) authorizes the Service to disregard community property laws by denying the benefits of income splitting between the spouses. IRC 66(b) may be applied under the following conditions:
 - a. The spouse acted as if they were solely entitled to the community income, and
 - b. The spouse failed to notify the other spouse of the nature and amount of the income before the due date of the return (including extensions) for the taxable year in which the income was derived.
- (2) IRC 66(b) entitles the Service to shift the item of income and assess additional tax against the spouse earning the income. The tax must be assessed in accordance with IRC 6212 (deficiency procedures). Where IRC 66(b) is asserted, it must be clearly reflected on the notice of deficiency. The determination must be supported by evidence that IRC 66(b) applies. If the notice fails to do this, the burden of proof may be shifted to the Service. *Shea v. Commissioner*, 112 T.C.183 (1999). See IRC 66(b) and 26 CFR 1.66-3(b).
- (3) Only the Service can invoke IRC 66(b). It is not a relief provision that can be invoked by a taxpayer to escape liability. *Hardy v. Commissioner*, 181 F.3d 1002 (9th Cir. 1999); *Drummer v. Commissioner*, T.C. Memo,1994-214, aff'd without published opinion, 68 F.3d 472 (5th Cir. 1995).
- (4) **Solely entitled to income:** to determine whether a spouse has acted as if he or she was solely entitled to the income, consider the facts and circumstances focusing on whether the spouse used, or made available, the item of income for the benefit of the marital community. See 26 CFR 1.66-3(a). For instance:
 - Where the community property at issue is deposited into a joint account or an account over which both spouses have signature authority, the spouse who deposited the funds did not act as though he or she was solely entitled to the funds. *Cox v. Commissioner*, T.C. Memo. 1993-559; *Drummer v. Commissioner*, T.C. Memo. 1994-214, aff'd without published opinion, 68 F.3d 472 (5th Cir. 1995).
 - Where a spouse sends a portion of the funds to the other spouse, that spouse has not acted as though he or she was solely entitled to the funds. *Mischel v. Commissioner*, T.C. Memo 1997-350; 26 CFR 1.66-3(c), Example 1(ii).
 - If the community income is retained by one spouse and spent at his or her discretion, that spouse has acted as though he or she was solely entitled to the income. See 26 CFR 1.66-3(c), Example 1(i).
- (5) **Notification of nature and amount of income:** a spouse who provides a copy of a Form 1099 or Form W-2 to the other spouse satisfies the notification of the nature and amount of income requirement. If notification is done before the due date of the return (including extensions), IRC 66(b) is inapplicable. See 26 CFR 1.66-3(c), Example 2, for additional information.

25.18.2.4
(02-15-2005)
Self-Employment Tax

- (1) **Sole Proprietorship.** Net income from a trade or business (other than a partnership) is treated as income of the spouse who exercises management and control over the trade or business. 26 CFR 1.1402(a)-8(a). *Heidig v. Commissioner*, T.C. Memo. 1986-411; *Tolotti v. Commissioner*, T.C. Memo. 1987-13. Management and control means actual management and control, not manage-

ment and control imputed from husband to wife under community property laws. 26 CFR 1.1402(a)-8. Therefore, the self-employment tax is imposed on the spouse actually carrying on the trade or business.

- (2) **Partnership.** The distributive share of each married partner's income or loss from a partnership trade or business is attributable to the partner for computing self-employment tax, even if a portion of the partner's distributive share of income or loss is otherwise attributable to the partner's spouse for income tax purposes. If both spouses are partners, the self-employment tax is allocated based on their distributive share. 26 CFR 1.1402(a)-8(b).

25.18.2.5
(03-10-2017)

Claiming of Deductions

- (1) There is limited impact of community property laws on the claiming of deductions if joint returns are filed. If separate returns are filed, in some circumstances a deduction may be required to be split between the spouses' separate returns. The following are rules with respect to deductions claimed on separate returns:
- a. **Expenses Associated With Income.** Expenses associated with income are characterized in the same manner as the income. *Johnson v. Commissioner*, 72 T.C. 340 (1979), acq. 1980-2 C.B. 1. Thus, for example, deductions associated with a Schedule C law practice generating community property income must be split, even if they are paid from separate property. *Finley v. Commissioner*, T.C. Memo. 1982-411. The rationale behind this rule is that the community income that is allocated to the spouses is not gross, but net taxable income, computed by deducting expenses incidental to its production. *Stewart v. Commissioner*, 35 B.T.A. 406, 410 (1937), aff'd, 95 F.2d 821 (5th Cir. 1938). Similarly, if the income is characterized as separate property, then the associated deductions are also treated as the separate property of the spouse who must report the income. If the income is allocated between separate and community property, the expenses should also be allocated proportionately. *Johnson v. Commissioner*, 72 T.C. 340 (1979), acq. 1980-2 C.B. 1.
 - b. **Deductions Not Related to Income.** Deductions that are not related to income (e.g., medical, charitable contributions, property taxes, state taxes) are split if paid with community property. If the expenses are paid with separate property, they are deductible by the spouse whose separate property was used to pay them. See *Stewart v. Commissioner*, 35 B.T.A. 406, 410 (1937), aff'd, 95 F.2d 821 (5th Cir. 1938); *Powell v. Commissioner*, T.C. Memo. 1967-32; see also *Hunt v. Commissioner*, 47 B.T.A. 829 (1942); *Bishop v. Commissioner*, 152 F.2d 389 (9th Cir. 1945); *Commissioner v. Newcombe*, 203 F.2d 128 (9th Cir. 1953); *Keeter v. United States*, 97-2 U.S.T.C. ¶ 50,940, 80 A.F.T.R.2d ¶ 97-5640 (E.D. Cal. 1997).
 - c. **Losses From Separate Property.** Losses sustained on the sale of separate property are reportable by the spouse who owned the separate property. *Stewart v. Commissioner*, 35 B.T.A. 406, 410 (1937), aff'd, 95 F.2d 821 (5th Cir. 1938). Losses sustained on the sale of community property are community property losses and must be split. *Allen v. Commissioner*, 22 T.C. 70 (1954), acq. 1954-2 C.B. 3.
 - d. **Business Losses.** Business losses funded with community property or which the taxpayer does not establish were funded with separate property are split between the spouses. *Allen v. Commissioner*, 22 T.C. 70 (1954), acq. 1954-2 C.B. 3. This also affects the amount that can be claimed in net operating loss carrybacks. *Tseng v. Commissioner*, T.C.

Memo. 1994-126, aff'd without published opinion, 79 F.3d 1154 (9th Cir. 1996), cert. denied, 519 U.S. 820 (1996).

- e. **Casualty Losses.** Casualty losses are deductible by the spouse who owned the property. If the property was community property, the loss deduction would be divided. *Kamins v. Commissioner*, 54 T.C. 977 (1970).
- f. **Bad Debts.** Bad debt deductions are generally split if the money was loaned from community property during the marriage. However, bad debt deductions for premarital loans or loans made with separate property are not split. *Stewart v. Commissioner*, 35 B.T.A. 406, 410 (1937), aff'd, 95 F.2d 821 (5th Cir. 1938); *Thorman v. Commissioner*, Nos. 15,674 and 15,675 (T.C. Memo. 1949). Payment of a post-community loan guarantee that is an obligation of the community is split. *Kleberg v. Commissioner*, 43 B.T.A. 277 (1941).
- g. **IRA Contributions.** Deductions for individual retirement account contributions cannot be split between spouses. The deduction for each spouse is figured separately and without regard to community property laws. IRC 219(f)(2).

25.18.2.6 (02-15-2005) Alimony or Separate Maintenance

- (1) Alimony or separate maintenance payments made prior to divorce are deductible by the payor and taxable to the payee only to the extent they exceed 50% of the reportable community property income. This is so because the payee spouse is already required to report half of the community property income, and will already be taxed on the payments. *Hunt v. Commissioner*, 22 T.C. 228 (1954).
- (2) If the payments exceed the payee spouse's 50% share of the community property income, the excess is treated as being paid first from the payor spouse's share of the current community property income (which is 100% taxable to the payee spouse), and then from the couple's accumulated community property (which is 50% taxable to the payee spouse). *Furgatch v. Commissioner*, 74 T.C. 1205 (1980).

25.18.2.7 (03-04-2011) Claiming of Credits

- (1) **Withholding credits.** Withholding credits from community property income are allocated 50% to each spouse. 26 CFR 1.31-1(a); 26 CFR 1.32-2(c)(2), *Gilmore v. United States*, 290 F.2d 942 (Ct.Cl. 1961), rev'd on other grounds, 372 U.S. 39 (1963).
- (2) **Estimated Tax Payments.** Estimated tax payments made in a separate declaration of estimated tax are the separate property of the spouse making the declaration. *Janus v. United States*, 557 F.2d 1268 (9th Cir. 1977); *Morris v. Commissioner*, T.C. Memo. 1966-245. These payments are separate property even if the source for them is community property. If spouses file a joint declaration of estimated tax and file separate returns, they may allocate the payments in any consistent manner that they may agree upon. If they cannot agree, and the source of the payment is known to be community property, the payment should be split. Usually, the source of the payment will not be known, however. Under these circumstances, the payments should be allocated in proportion to the tax liability reported on the returns as follows:

$$\text{Separate Tax Liability} \div \text{Both Tax Liabilities} \times \text{Estimated Tax Payments}$$

Rev. Rul. 80-7, 1980-1 C.B. 296, amplified by Rev. Rul. 87-52, 1987-1 C.B. 347; 26 CFR 1.6654-2(e)(5)(ii)(B); *United States v. Johnson*, 75-1 U.S.T.C. ¶ 9144, 35 A.F.T.R.2d ¶ 75-354 (D. Minn. 1974). If the spouses file a joint return and the character of the estimated tax payments becomes material (e.g., for an injured spouse claim under IRC 6402), the source of the payment is considered. *Elam v. United States*, 112 F.3d 1036 (9th Cir. 1997).

- (3) **Earned Income Credit.** Community property income splitting is disregarded in calculating the amount of earned income for purposes of the earned income credit. See IRC 32(c)(2)(B)(i). However, community property income splitting is considered in determining adjusted gross income for purposes of income limitations under IRC 32(a)(2) and IRC 32(b), if a taxpayer qualifies to file as head of household and is subject to community property laws. It should be noted, however, that these limitations are the greater of adjusted gross income or earned income. IRC 32(a)(2)(B).

25.18.2.8
(02-15-2005)
**Disclosure
Considerations**

- (1) There are potential disclosure problems in sharing income information between spouses filing separate returns. Generally, it is a potential disclosure violation to provide income information of one spouse to the other spouse even if it relates to community property. Exceptions exist to this general rule. For example, in the context of an audit of a husband's return, the wife's return information may be disclosed if the information is directly related to the resolution of an issue in the husband's audit. IRC 6103(h)(4)(B).

25.18.2.9
(07-28-2021)
Third-Party Contacts

- (1) When making third-party contacts, follow direction in IRM 25.27.1, Third-Party Contact Program, which provides guidance for third-party contact notice and reporting provisions contained in IRC 7602(c) and 26 CFR 301.7602-2. These rules do not apply to contacting spouses where they have filed a joint return. Where spouses filed separate returns or no returns, contacting a spouse with respect to the determination or collection of the tax liability of the other spouse is a third-party contact for purposes of IRC 7602(c). Absent taxpayer authorization or some other exception, IRS employees must comply with the third-party contact notice and reporting provisions contained in IRC 7602(c) and 26 CFR 301.7602-2.

25.18.2.10
(03-10-2017)
**Statutory Notice
Considerations for
Community Property
Adjustments to Income**

- (1) **Allocation of income.** Where spouses are living in a community property state and have not filed returns or filed separate returns and failed to report income, the Service is faced with the issue of how to allocate the income between the spouses. If the income is community property, it should be split between the spouses, and if the income is separate property, it should be taxed to the spouse who earned or accrued it.
- (2) **Uncooperative Nonfilers.** Often, in the case of nonfilers, the Service will have no specific information establishing whether income is community property, because the spouses are not cooperating and no other information is available. In this circumstance, state law presumes that the income is community property. For purposes of allocating income between the spouses for an examination report or a notice of deficiency, the Service will follow the state law presumption that the income is community property. All income should be split equally between the spouses, unless there is a federal preemption that requires treatment of an item as separate property (e.g., IRA withdrawals, social security benefits, etc.). In the case of an uncooperative nonfiler, where his or her spouse has filed a separate return reporting income without regard

to community property, the filing spouse should be contacted to determine if community property reporting rules apply. However, if the filing spouse also does not cooperate, the state law presumption that the income is community property should be followed. If the statute of limitations on assessment is open with respect to the separate return of the filing spouse, and it appears that the return did not report income correctly, the filed separate return should also be considered for examination.

- (3) **Income adjustments – filed returns.** Where spouses have filed separate returns and failed to report an item of income, the Service can usually determine whether the unreported item is community property by contacting the spouses. If the spouses are uncooperative, the Service should follow the presumption that the item is community property and split it between the returns. If the spouses' returns were not filed on a community property basis, it may be necessary to adjust the returns to put them on the correct basis.
- (4) **Whipsaws.** In some cases, spouses will disagree about whether an item is community property, and the Service will not be able to make a determination with any certainty. In other cases, a spouse may seek relief under IRC 66. In these or any other circumstances where there is a realistic possibility that revenue will be lost if a protective position is not taken, the Service should whipsaw the income against both spouses. The whipsaw should not be set up simply because the Service has no information about the spouses' position on the issue. However, if the Service does set up a whipsaw, 100% of the item should be allocated to the spouse who earned or accrued the income as separate property, and 50% to the other spouse as community property. Since this would result in taxing more than 100% of the income, if the spouses subsequently agree to a consistent allocation or if a court imposes one, the inconsistent portion of the adjustment should be conceded. Any item whose treatment as separate property is mandated by federal law should be treated accordingly (e.g., IRA withdrawals, earned income credit, social security benefits).
- (5) **Lost Revenue.** Following the state presumption that income is community property can sometimes result in lost revenue. For example, assume a husband and wife do not file returns. The only income is wages in the husband's name. The Service treats the income as community property and issues notices of deficiency to each spouse allocating half of the wages to each spouse. The husband does not respond to the statutory notice and his case is closed. The wife files a petition with the Tax Court and produces a marital agreement that the husband's wages are his separate property. In that case, the adjustment to the wife would be conceded. The half of the income allocated to the wife, but actually taxable to the husband, could go untaxed. If this occurs, consideration should be given to reopening the other spouse's return to include the other half of the income. Whether the loss of revenue justifies reopening the other spouse's liability will depend on whether the failure to reopen would be a "serious administrative omission." This will depend on the same factors applicable to any other reopening, including whether there is an open statute for assessment and whether the lost revenue is sufficient to justify the administrative expense of reopening the liability. Note: If the other spouse has not filed a return, the statute of limitations for assessing the deficiency would not have begun to run. See IRC 6501(c)(3). For the criteria applicable to determining whether a tax liability can be reopened, see Policy

Statement 4-3, reprinted in IRM 1.2.1.5.1, Cases Closed by District Directors or Service Center Directors Will Not Be Reopened Except Under Certain Circumstances.

25.18.2.11
(02-15-2005)
**Bureau of Labor
Statistics**

- (1) If Bureau of Labor Statistics (BLS) are used in a community property state as the basis for a reconstruction of income, the appropriate family figure for the cost of living (not the BLS income figure) for the spouses and any dependents should be used. This figure should be split and half allocated to each spouse. Before BLS can be used in any case, the Service should be able to demonstrate (1) that the taxpayer did not cooperate in the audit, and (2) that there is evidence of taxable income, but no information can be readily acquired to ascertain the amount of such income.

25.18.2.12
(03-04-2011)
**Classification of
Community Property
Limited Liability
Companies**

- (1) Where a limited liability company (an "LLC") is wholly owned by a husband and wife as community property under the laws of a state, the Service will respect the taxpayers' treatment of the entity as either a partnership or disregarded entity. Rev. Proc. 2002-69, 2002-45 I.R.B. 831; IRM 5.1.21.10.2, Community Property Considerations.

Income Reporting Considerations of Community Property 25.18.2

page 13

Exhibit 25.18.2-1 (02-23-2018)

IRC 66(a) and IRC 66(b) Pro Forma Check sheets for Examiners

- Pro forma check sheet for examiners, IRC 66(a)—Treatment of Community Income Where Spouses Live Apart.

IRC 66(a) – Treatment of Community Income Where Spouses Live Apart

All requirements **must** be met for IRC 66(a) to apply. IRC 66(a) is not a relief provision, but provides an exception to the general rule that community income is taxed half to each spouse domiciled in a community property state.

Eligibility Qualifications:	YES	NO
The spouses are married to each other at any time during the taxable year.		
The spouses do not file a joint return for the calendar year.		
The spouses live apart at all times during the calendar year.		
One or both spouses had earned income that is community property.		
No part of the community income is transferred (directly or indirectly) between the spouses during the calendar year.		
Conclusion:	YES	NO
IRC 66(a) applies?		

Examiner's Comments:

Conclusion:

- Pro forma check sheet for examiners, IRC 66(b)— Denial of Benefits of Community Property Law Where Spouses Not Notified.

Exhibit 25.18.2-1 (Cont. 1) (02-23-2018)**IRC 66(a) and IRC 66(b) Pro Forma Check sheets for Examiners****IRC 66(b) – Denial of Benefits of Community Property Law Where Spouse Not Notified**

All requirements must be met, and invocation of IRC 66(b) is at the Service's discretion. A taxpayer cannot apply for IRC 66(b) relief.

Total Amount of Items (Requesting Spouse's Half):

Eligibility Qualifications:	YES	NO
The item was treated by the spouse as if he or she were solely entitled to the income.		
The spouse did not notify the other spouse of the nature and amount of the income by the due date for filing the return (including extensions).		
Conclusion:	YES	NO
IRC 66(b) applies?		

Examiner's Comments:

Conclusion: