



# **Federal and Wisconsin Income Tax Reporting Under the Marital Property Act**

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**IMPORTANT CHANGES**

Use this publication in preparing your 2021 tax return. The following are new for 2021:

- Changes to the federal earned income credit computation do not apply for Wisconsin purposes. See page 32.
- Changes to the amount allowed for purposes of the federal child and dependent care credit do not apply for purposes of the Wisconsin subtraction for child and dependent care expenses. See page 33.

In this publication, the "Federal Treatment" reflects the interpretations of Wisconsin's Marital Property Act by the Milwaukee office of the Internal Revenue Service (IRS) and the "Wisconsin Treatment" reflects the interpretations by the Wisconsin Department of Revenue as of December 1, 2021. Federal and state laws enacted after this date, new federal regulations and rulings, new state administrative rules, and federal and state court decisions may change the interpretations in this publication.

The Department of Revenue acknowledges the Milwaukee office of the IRS for writing the "Federal Treatment" portion of this publication.

## 1. BACKGROUND

### Federal Treatment

On January 1, 1986, Wisconsin joined eight other states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington) as a jurisdiction whose laws are administered under the community property concept. The Wisconsin Marital Property Act creates a type of property under state law that is referred to as marital property. The IRS has ruled that marital property in Wisconsin is a form of community property and is to be treated that way for tax purposes. [Rev. Rul. 87-13] While the Marital Property Act indirectly affects everyone who lives in Wisconsin, it only directly affects the property of married individuals.

The date that married couples become subject to the Marital Property Act is referred to as the "determination date." [See sec. [766.01\(5\)](#), Wis. Stats.] This is the date **after** all of the following have occurred: the date of marriage, January 1, 1986 (the effective date of the Act), **and** the date both spouses become domiciled in Wisconsin. "Domicile" is a legal concept that, in this context, is similar to establishing permanent legal residency.

Although there are exceptions, property acquired by spouses after the determination date is marital property. [Sec. [766.31\(1\)](#), [\(2\)](#), and [\(4\)](#), Wis. Stats.; see also the exceptions in sec. [766.31\(7\)](#), Wis. Stats.] As will be discussed, the statute gives each spouse an undivided half interest in marital property. [Sec. [766.31\(3\)](#), Wis. Stats.] The Act does not, by itself, change the character of property owned by spouses prior to the effective date of the Act, prior to both spouses establishing a Wisconsin domicile, or prior to the marriage. [Sec. [766.31\(6\)](#) and [\(9\)](#), Wis. Stats.] Property owned by a spouse prior to marriage is their individual property. [Sec. [766.31\(6\)](#), Wis. Stats.] Property owned by a spouse prior to January 1, 1986, or prior to both spouses establishing a Wisconsin domicile is not reclassified but is treated as if it were individual property. [Sec. [766.31\(9\)](#), Wis. Stats.] Property can be reclassified in several different ways under the Act. The simplest way is by entering into a marital property agreement. [Sec. [766.31\(10\)](#), Wis. Stats.]

Community property has historically been subject to special treatment under the tax laws. [See *Poe v. Seaborn*, 282 U.S. 101 (1930).] The adoption of marital property law in Wisconsin affects the reporting, payment, and collection of income taxes. The effect of the Marital Property Act on federal taxation is complex. There is no way that it can be thoroughly addressed in this type of publication. The purpose of this publication is merely to provide general guidance. We have cited legal authority (both statutory and case law), as appropriate, in brackets [ ] for some of the rules that are stated in this publication. For further information, these sources can be consulted.

## Wisconsin Treatment

As part of marital property reform, Wisconsin adopted the concept of joint income tax returns for married persons. Under prior law, each spouse was required to report their own income separately, either on separate forms or in separate columns on the same form (called a "combined" return). Joint returns simplify income tax filing for the majority of married couples. If spouses do file separately, the income that each spouse must report is determined under marital property law rather than under common law. Because the marital property law does not address many income tax issues, the reporting of income on separate returns may be difficult.

## 2. TERMS USED IN THIS PUBLICATION

Following is a discussion of terms used in this publication.

**Common Law Property System** - Under the common law property system, property acquired during marriage generally belongs to the spouse who acquired the property. The title to property generally determines ownership of property between spouses. A spouse owns and has complete control over property titled in that spouse's name. A spouse owns the income from their own property. For tax purposes, the title to property determines what income is reportable by each spouse on separate returns filed while domiciled in a common law property state.

**Marital Property System** - Under the marital property system, property acquired during marriage generally belongs to both spouses equally. The spouses are equal partners, whether each contributes money or services or both to the marriage, and both spouses will share equally all property acquired during the marriage, except property that one spouse alone inherits or receives as a gift from another person. Generally, the spouses own equally what either earns or buys and the income from property owned by either of them. However, a spouse has the right to manage and control property titled in their own name and property titled in neither spouse's name. Under the marital property system, the classification of property generally determines ownership of property between spouses. In the absence of an agreement or court order, the classification of property is based on when and how the property was acquired. The classification of the property also determines what income is reportable by each spouse on separate income tax returns while domiciled in Wisconsin.

**Note:** This publication often refers to "income earned by a spouse" or "the spouse's earnings." However, the income produced by a spouse's efforts or property is treated as if it were earned by both spouses under the Marital Property Act.

**Determination Date** - Wisconsin's marital property law applies to spouses after the "determination date." The determination date is the last to occur of the following [sec. [766.01\(5\)](#), Wis. Stats.]:

- January 1, 1986
- Date of marriage
- Date both spouses establish a Wisconsin domicile

**Note:** The marital property law generally applies for all purposes only while both spouses are domiciled in Wisconsin.

**Domicile** - A person's domicile is their true, fixed, and permanent home where they intend to remain permanently and indefinitely and to which, whenever absent, they intend to return.

**Classification of Property** - Under the marital property law, all property that spouses acquire after the determination date is generally classified as "marital property" or "individual property." Note that these rules may not apply for purposes of determining the basis of property upon the death of a spouse. For more information on basis, see Part 6 on page 42.

**Marital Property** - Marital property is all property classified as marital property and all property acquired by either spouse after the determination date, unless it is otherwise classified by the marital property law. [Sec. [766.31\(1\)](#), Wis. Stats.] The law presumes that all property owned by spouses is marital property. [Sec. [766.31\(2\)](#), Wis. Stats.] Any person who contends that certain property isn't marital property must prove that the property's classification is something else. Each spouse has a present, undivided one-half ownership interest in each item of marital property. [Sec. [766.31\(3\)](#), Wis. Stats.]

Marital property generally includes:

- Income earned or accrued by a spouse or derived from marital property and nonmarital property owned by a spouse during the marriage and after the determination date.

"Income" means wages, salaries, commissions, bonuses, gratuities, payments in kind, deferred employment benefits, proceeds other than death benefits of any health, accident, or disability insurance policy or of any plan, fund, program, or other arrangement providing benefits similar to those forms of insurance, other economic benefits having value attributable to the effort of a spouse, dividends, dividends on life insurance and annuity contracts to the extent that the aggregate of the dividends exceeds the aggregate premiums paid, interest, income distributed from trusts and estates, and net rents and other net returns attributable to investment, rental, licensing, or other use of property, unless attributable to a return of capital or to appreciation. [Sec. [766.01\(10\)](#), Wis. Stats.]

- The substantial increase in value of nonmarital property which resulted from the substantial efforts of either spouse that weren't reasonably compensated. [Sec. [766.63\(2\)](#), Wis. Stats.]
- Nonmarital property that is mixed with marital property and can no longer be identified by tracing. [Sec. [766.63\(1\)](#), Wis. Stats.]

**Individual Property** - Individual property is property owned by one spouse alone under the marital property system. After the determination date and during the marriage, individual property includes:

- Property acquired by one spouse by gift or inheritance during the marriage. [Sec. [766.31\(7\)\(a\)](#), Wis. Stats.]
- Property acquired in exchange for, or with the proceeds of, individual property. [Sec. [766.31\(7\)\(b\)](#), Wis. Stats.]
- The increase in value of individual property, except to the extent that this increase in value is classified as marital property. [Sec. [766.31\(7\)\(c\)](#), Wis. Stats.] (Predetermination date unclassified property is treated "as if" individual property. [Sec. [766.31\(9\)](#), Wis. Stats.]
- Income (and principal) to one spouse from a trust created by a third person, unless the trust provides otherwise. [Sec. [766.31\(7\)\(a\)](#), Wis. Stats.]
- Income from a gift of property from one spouse to the other spouse, unless the spouse making the gift provides otherwise. [Sec. [766.31\(10\)](#), Wis. Stats.]
- Income or property designated individual property by a marital property agreement or a court decree. [Sec. [766.31\(7\)\(d\)](#), Wis. Stats.]
- Income derived from the nonmarital property of a spouse which that spouse has designated in a unilateral statement as their individual income. [Secs. [766.31\(7p\)](#) and [766.59](#), Wis. Stats.]
- For marriages occurring after December 31, 1985, property owned at a marriage by a Wisconsin-domiciled person. [Sec. [766.31\(6\)](#), Wis. Stats.]

**Unclassified Property** - Property owned by spouses before their determination date isn't classified by the Marital Property Act. Such unclassified property is treated as if individual property during the marriage. At death, property of the decedent spouse acquired during the marriage and before the determination date, which would have been marital property if acquired after the determination date, is treated as if it were marital property for certain elective rights of the surviving spouse.

**Mixed Property** - If marital property is mixed with any other type of property, the other type of property becomes marital property, unless that other type of property can be traced. This mixing rule doesn't apply for income tax basis purposes for property held in joint tenancy or tenancy in common. See Part 6 on page 42 for more information.

**Marital Property Agreement** - A marital property agreement is an agreement solely between spouses. The agreement must be in writing, and it must be signed by both spouses. It remains in effect until replaced by another marital property agreement. [Sec. [766.58](#), Wis. Stats.] The law provides special forms for "statutory property classification agreements." Spouses may use these agreements to classify their marital property as the individual property of the owning spouse or to classify all of their property as marital property. If there is no disclosure of assets and liabilities, the agreement terminates three years after the date both spouses sign the agreement. However, if the spouses complete the disclosure form which is provided as an attachment to the agreement form, the agreement is effective until dissolution of the marriage or death. Either spouse may, however, terminate a statutory property classification agreement unilaterally. [Secs. [766.588](#) and [766.589](#), Wis. Stats.]

**Unilateral Statement** - A unilateral statement is a document affecting the income from nonmarital property. The statement must be in writing, signed by the spouse who owns the nonmarital property, and notarized. Within five days after signing the statement, the spouse must deliver a copy to the other spouse. A unilateral statement applies only to income accrued after it is signed. A unilateral statement may be revoked at any time by delivering a copy of the revocation to the other spouse. It does not apply to earned income. [Sec. [766.59](#), Wis. Stats.]

### 3. SAME-SEX MARRIAGE IN WISCONSIN

#### Federal Treatment

In United States v. Windsor, 570 U.S. 744 (2013), the Supreme Court struck down the provision in the Federal Defense of Marriage Act ("DOMA"), defining marriage as a union between a man and a woman as a violation of the Fifth Amendment. In that case, the executor of a decedent who was part of a same-sex marriage in New York, a state recognizing same-sex marriage, attempted to claim the marital deduction on a federal estate tax return for assets passing to the surviving same-sex spouse. The IRS disallowed the deduction citing DOMA. The Supreme Court held the DOMA provision unconstitutional and allowed the deduction.

Subsequent to the Windsor opinion, on October 6, 2014, same-sex marriage became legal in Wisconsin following the resolution of a lawsuit challenging the state's ban on same-sex marriage. On that day, the U.S. Supreme Court refused to hear an appeal of a federal court ruling that found Wisconsin's ban on same-sex marriage unconstitutional. [See Wolf v. Walker, 986 F.Supp.2d 982 (W.D.Wis. Jun 06, 2014), aff'd sub. nom. Baskin v. Bogan, 766 F.3d 648 (7th Cir. Sep 04, 2014), cert. denied, Baskin v. Bogan, 135 S.Ct. 316 (Oct 06, 2014)]

Following the Supreme Court's ruling in Windsor, the IRS issued Rev. Rul. 2013-17. In that Revenue Ruling, the IRS ruled that same-sex couples who are married in states that recognize same-sex marriage are entitled to file joint federal income tax returns. Thus, same-sex couples who domicile in Wisconsin and are married in Wisconsin or another state recognizing same-sex marriage may file joint returns. This also means that if they file joint returns, they have joint and several liability for the resulting income taxes, the same as traditional married couples. I.R.C. § 6013(d)(3). They may also be able to avoid joint liability through innocent spouse procedures the same as traditional married couples.

On June 26, 2015, the U.S. Supreme Court issued its opinion in Obergefell v. Hodges, 135 S. Ct. 2584 (2015), holding that same-sex couples have the right to marry and have their marriages recognized in all states. Thus, any same-sex couple who is married in another state and moves to Wisconsin will have their marriage recognized as a valid marriage in Wisconsin.

This also means that these couples are now subject to the Wisconsin Marital Property Act. The rules for income taxation and collection of taxes apply to them the same as they apply to traditional married couples. Thus, all of the

marital property issues discussed in this publication could also apply to same-sex married couples just as they could apply to any traditional married couple.

### Wisconsin Treatment

As a same-sex couple that is considered lawfully married for federal income tax purposes is considered married for Wisconsin income tax purposes, the "Wisconsin Treatment" information in this publication applies to a lawfully married same-sex couple.

## 4. INCOME, DEDUCTIONS, CREDITS AND TAX PAYMENTS

### A. Reporting Marital Property Income

#### Federal Treatment

The Wisconsin Marital Property Act may change the manner of reporting income and claiming deductions on federal income tax returns. With a few limited exceptions, the Marital Property Act provides that income earned or accrued by a spouse after the determination date is marital property. [Sec. [766.31\(4\)](#), Wis. Stats.] Income is defined by the statute as including, among other things, wages, interest, dividends, and economic benefits attributable to the efforts of a spouse. [See sec. [766.01\(10\)](#), Wis. Stats.] Generally, interest and dividend income will be marital property even if the property that generates the income is not marital property. For example, dividends received after the determination date on stock purchased before the determination date would still be marital property.

The most notable exception to the rule that all income is marital property has to do with appreciation in value of individual property. The appreciation in value of individual property of a spouse is individual property, unless the appreciation is substantial and attributable to substantial efforts of either spouse that were not reasonably compensated. [Secs. [766.31\(7\)\(c\)](#) and [766.63](#), Wis. Stats.] Thus, for example, if real estate that was purchased prior to marriage increases in value because of market conditions, the increase in value is individual property. If, however, the increase in value is due to the substantial efforts of one of the spouses (the application of one spouse's industry and beyond normal maintenance) after the determination date that were not reasonably compensated, then the increase in value is marital property. [Secs. [766.31\(7\)\(c\)](#) and [766.63\(2\)](#), Wis. Stats.; *Estate of Kobylski v. Hellstern (In re the Estate of Kobylski)*, 178 Wis.2d 158 (App. 1993); *Bille v. Zuraff (In re the Estate of Bille)*, 198 Wis.2d 867 (App. 1995).]

Under the Act, each spouse has an undivided 50% interest in marital property. [Sec. [766.31\(3\)](#), Wis. Stats.] If spouses file a joint return, there is no tax impact from marital property law, because all income of both spouses (including any marital property income) is reported on one return. But when spouses file separate returns, the spouses must determine how to divide the income. In common law states, this is not difficult. Each spouse reports their own wages or other income from their labors, and any income attributable to property he or she owns. Under community property principles, since each spouse has a half interest in income that is marital property, each spouse should report half of that income. [*Poe v. Seaborn*, 282 U.S. 101 (1930).]

The reporting of marital property income is best illustrated by the following examples:

**Example 1:** Spouse A and Spouse B were married during 2020. During 2021, Spouse A is unemployed and receives no wage income. Spouse B receives wages of \$20,000. Spouse B has \$5,000 of withholding from wages. In this case, if Spouse A and Spouse B file separate returns, each would report income of \$10,000 (one-half of the wages received by Spouse B). Each also would report half of the withholding.

**Example 2:** Spouse A and Spouse B were married during 2020. During 2021, Spouse A receives wages of \$50,000. Spouse B owns a service business and makes a profit of \$80,000. Spouse A also receives interest of \$2,000 on a savings account started prior to marriage. Spouse B receives dividends of \$2,500 on stock purchased

before marriage. Spouse B sells the stock for a profit of \$3,000. On their separate returns, each would report the following:

Item	A	B
Wages earned by Spouse A	\$25,000	\$25,000
Business income of Spouse B	40,000	40,000
Interest	1,000	1,000
Dividends	1,250	1,250
Capital gain on stock	-0-	3,000
Total income reported	\$67,250	\$70,250

All of the income in this example is marital property, except for the income from the sale of the stock. This income is not marital property, because it is appreciation in value of individual property. Yet the dividends from the same property are marital property and should be split if separate returns are filed.

In either of the above examples, each spouse could claim half of the credit for any federal income tax withheld. Similarly, with certain exceptions, each spouse could claim half of any deductions.

As will be discussed later, spouses can change the effect of the Marital Property Act with respect to the reporting of income and deductions by entering into a marital property agreement.

Although splitting marital property income is the correct way to report it, filing a return in this manner could result in future contacts from the IRS. In the examples on the previous above, Forms W-2 would be issued in the name of one spouse alone. When a Form W-2 is sent to the IRS by the employer, it is reported as though it is entirely the income of one spouse.

The IRS matches information received under social security or taxpayer identification numbers with filed returns to ensure that all income is reported. In the examples on the previous above, when the matching process takes place, the Form W-2 will not reconcile with the return, unless the return contains an explanation. If there is no explanation, the IRS will contact the taxpayer. To avoid this contact, it is necessary to explain the discrepancy on the return. The easiest way to do this is to use federal [Form 8958, Allocation of Tax Amounts Between Certain Individuals in Community Property States](#). Thus, under Example 1 on page 7, Spouse A's and Spouse B's allocation of community property income would reflect the amounts indicated in Exhibit 1 on the next page.



**EXHIBIT 1**  
**Allocation Worksheet**

	1 Total Income (Community/Separate)	2 Allocated to Spouse A	3 Allocated to Spouse B
1. Wages (each employer)	\$20,000	\$10,000	\$10,000
2. Interest Income (each payer)			
3. Dividends (each payer)			
4. State Income Tax Refund			
5. Capital Gains or Losses			
6. Pension Income			
7. Rents, Royalties, Partnerships, Estates, Trusts			
8. Taxes Withheld	\$5,000	\$2,500	\$2,500
9. Other items such as: Social Security Benefits, Business & Farm Income or Loss, Unemployment Compensation, Mortgage Interest Deduction, etc.			

**NOTES**

Spouses are reporting their income and tax withholding pursuant to the Wisconsin Marital Property Act

Spouse's Name:

Spouse's SSN:

**EXHIBIT 2****Spouse A's**

**Worksheet for Married Persons Filing Separate  
Returns and Persons Divorced in 2021**  
Attach to your 2021 Wisconsin income tax return

Fill in your name and social security number

	Total marital property of you and your spouse	Marital property amount you are reporting	Other amount you are reporting	Total amount you are reporting on your 2021 return
1. Wages, salaries, tips, etc.	\$20,000	\$10,000	-0-	\$10,000
2. Interest income				
3. Dividends				
4. Business income or (loss)				
5. Capital gains or (losses)				
6. Pensions, IRA distributions and annuities				
7. Rents, royalties, partnerships, estates, trusts, etc.				
8. Farm income or (loss)				
9. Unemployment compensation				
10. Social security benefits				
11. Other income				
12. Wisconsin taxes withheld	\$1,000	\$500	-0-	\$500
13. Wisconsin estimated tax payments				

Check the box which explains how you are figuring the amounts to report on your 2021 Wisconsin income tax return.

- I am figuring my income and withholding for 2021 based on Wisconsin's marital property law.
- I became married in 2021. I am figuring my income and withholding based on Wisconsin's marital property law for the period from \_\_\_\_ to \_\_\_\_.
- I became divorced in 2021. I am figuring my income and withholding based on Wisconsin's marital property law for the period from \_\_\_\_ to \_\_\_\_\_. My former spouse's name and social security number are \_\_\_\_\_.
- I was a part-year Wisconsin resident, or I was married to a part-year Wisconsin resident in 2021. I am figuring my income and withholding based on Wisconsin's marital property law for the period from \_\_\_\_ to \_\_\_\_.
- I am figuring my income and withholding to reflect a marital property agreement or unilateral statement.
- Other reason-explain here. \_\_\_\_\_

**EXHIBIT 3**

**Spouse B's**

**Worksheet for Married Persons Filing Separate Returns and Persons Divorced in 2021**  
 Attach to your 2021 Wisconsin income tax return

Fill in your name and social security number

	Total marital property of you and your spouse	Marital property amount you are reporting	Other amount you are reporting	Total amount you are reporting on your 2021 return
1. Wages, salaries, tips, etc.	\$20,000	\$10,000	-0-	\$10,000
2. Interest income				
3. Dividends				
4. Business income or (loss)				
5. Capital gains or (losses)				
6. Pensions, IRA distributions and annuities				
7. Rents, royalties, partnerships, estates, trusts, etc.				
8. Farm income or (loss)				
9. Unemployment compensation				
10. Social security benefits				
11. Other income				
12. Wisconsin taxes withheld	\$1,000	\$500	-0-	\$500
13. Wisconsin estimated tax payments				

Check the box which explains how you are figuring the amounts to report on your 2021 Wisconsin income tax return.

- I am figuring my income and withholding for 2021 based on Wisconsin's marital property law.
- I became married in 2021. I am figuring my income and withholding based on Wisconsin's marital property law for the period from \_\_\_\_\_ to \_\_\_\_\_.
- I became divorced in 2021. I am figuring my income and withholding based on Wisconsin's marital property law for the period from \_\_\_\_\_ to \_\_\_\_\_. My former spouse's name and social security number are \_\_\_\_\_.
- I was a part-year Wisconsin resident, or I was married to a part-year Wisconsin resident in 2021. I am figuring my income and withholding based on Wisconsin's marital property law for the period from \_\_\_\_\_ to \_\_\_\_\_.
- I am figuring my income and withholding to reflect a marital property agreement or unilateral statement.
- Other reason-explain here. \_\_\_\_\_

## Wisconsin Treatment

As for federal purposes, Wisconsin's Marital Property Act generally won't affect spouses who file a joint Wisconsin income tax return. However, spouses who file separate Wisconsin income tax returns, or persons who become divorced during the tax year, are likely to be affected by the Marital Property Act. Since each spouse has an undivided 50% interest in marital property income, each spouse generally must report half of that income on separate returns. Examples 1 and 2 on page 7 also illustrate the reporting of marital property income for Wisconsin purposes.

Married persons who file separate returns, or persons who file individually because they are divorced during the year, are likely to be questioned if it isn't clear to the Department of Revenue how they have allocated their income, deductions, or credits or if it appears that they haven't reported all of their income. Therefore, such persons who file separate or individual Wisconsin returns should enclose a copy of the *Worksheet for Married Persons Filing Separate Returns and Persons Divorced in 2021*, which is included in the back of Wisconsin [Publication 109](#), *Tax Information for Married Persons Filing Separate Returns and Persons Divorced in 2021*. On this worksheet they show how they figured the income, deductions, and credits that each is reporting.

Thus, under Example 1 on page 7, Spouse A's and Spouse B's worksheets would reflect the amounts indicated in Exhibits 2 and 3 on pages 10 and 11. In this example, assume that \$1,000 of Wisconsin income tax is withheld from Spouse B's wages.

If spouses or former spouses treat items on their separate or individual returns inconsistently, the department will contact both of them in order to resolve the discrepancies. For example, the department may question a spouse who reports one-half of the wages he or she earned but claims all of the withholding from those wages.

## B. Exception to Marital Property Reporting - Innocent Spouse

### Federal Treatment

#### (1) Innocent Spouse

Where spouses file joint returns, there is limited impact of the marital property laws with respect to innocent spouse relief. Under section [6015](#) of the Internal Revenue Code (IRC), spouses may be eligible for relief from joint and several liability on joint returns. Determinations under this section are made without regard to community property. [IRC sec. [6015\(a\)](#).] Innocent spouse relief on joint federal income tax returns is beyond the scope of this publication, which deals exclusively with Wisconsin marital (community) property. For a discussion of innocent spouse relief on joint returns, please refer to IRS [Publication 971](#), *Innocent Spouse Relief*, and section [6015](#) of the IRC.

#### (2) Innocent Spouse and Collection from Community Property

It should be noted, however, that whether a spouse has received innocent spouse relief under section [6015](#) or section [66](#) of the IRC does not affect the IRS's ability to collect from the liable spouse's interest in community property. [United States v. Stolle, 2000-1 U.S.T.C. ¶ 50,329, 86 A.F.T.R. 2d ¶ 5180 (C.D. Cal. 2000).] For a discussion of IRS tax collection remedies under Wisconsin marital property law, see *Delinquent Taxes and the Marital Property Act - Federal Treatment*, on page 33.

#### (3) Section 66

As discussed earlier, by virtue of the Marital Property Act, a spouse filing a separate return must report one half of the wages earned by the other spouse as income. This can create problems when, as frequently happens, spouses do not live together and do not communicate. Congress recognized this problem and enacted section [66](#) of the IRC to deal with it.

Section [66](#) of the IRC suspends community (or marital) property reporting rules in certain circumstances. It has three provisions which could affect the reporting of community property income. The first provision, section [66\(a\)](#) of the IRC, is general in effect. This means that if it applies, spouses report most community property income as though they received it under common law rules. The second section, section [66\(c\)](#) of the IRC, is a more specific provision. It is the community property equivalent of an "innocent spouse" provision. It removes the burden of reporting half of certain items of community property income of the other spouse. A third provision, section [66\(b\)](#) of the IRC, allows the IRS to require one spouse to report 100% of an item of community property income. All three provisions have specific requirements that must be met if they are to apply.

(4) Section 66(a)

Section [66\(a\)](#) of the IRC provides that if all of the following occur, then community income is treated in accordance with section [879](#) of the IRC:

- The spouses are married to each other at any time during the calendar year
- The spouses live apart at all times during the calendar year
- The spouses do not file a joint return for the calendar year
- One or both spouses had earned income that is community property
- No part of such earned income is transferred between the spouses during the calendar year (this does not include child support or de minimis amounts)

This means that, for most purposes, community property income is not split between the spouses. If section [66\(a\)](#) of the IRC applies, earned income (other than trade or business income) must be reported by the spouse who earned it. Trade or business (Schedule C) income must be reported by the spouse unless the other spouse exercised substantially all management and control over the business. Income from a partnership is taxed to the partner spouse. Community income derived from separate property of one spouse is treated as the income of that spouse. All other community income is treated as provided under the applicable state community property law. Section 66(a) of the IRC is not elective. Where it applies, its requirements must be followed.

(5) Section 66(c) – Traditional Relief

A second provision, section [66\(c\)](#) of the IRC, is not as broad and may apply to all items of community property or only a few. This section provides that if all of the following occur, then the unreported item of income will be taxed wholly to the other spouse, and not split:

- The spouse did not file a joint return
- The spouse did not report an item of community income attributable to the other spouse (see the paragraph above for the categories) on an income tax return
- The spouse did not know, or have reason to know, of the item of community income
- Considering all facts and circumstances it would be inequitable to require the spouse to include the item in gross income

This is referred to as traditional relief under section [66\(c\)](#) of the IRC. Courts have interpreted the requirement that the spouse not know or have reason to know of the community income narrowly. If a spouse is aware that the other spouse is earning or receiving specific community income, that spouse will not qualify for relief under section [66\(c\)](#) of the IRC. A spouse with such knowledge has "reason to know" of the community income. It does not matter that the spouse does not know how much income was earned.

[*Hardy v. Commissioner*, 181 F.3d 1002 (9th Cir. 1999); *McGee v. Commissioner*, 979 F.2d 66 (5th Cir. 1993); and *Horner v. Commissioner*, T.C. Memo 1994-447.]

Relief under section [66\(c\)](#) of the IRC is elective. A requesting spouse seeking relief under section [66\(c\)](#) of the IRC must file [Form 8857](#), *Request for Innocent Spouse Relief*, or other similar statement signed under penalties of perjury, within the applicable statute of limitations.

(6) Section 66(c) – Equitable Relief

The IRS may still relieve a taxpayer of liability for any unpaid tax or any deficiency or any portion thereof attributable to an item of community (marital) income for which relief is not available under section [66\(c\)](#) of the IRC, if taking into account all the facts and circumstances, it is inequitable to hold the taxpayer liable. [I.R.C. § [66\(c\)](#).] This is referred to as equitable relief under section [66\(c\)](#) of the IRC. In making this determination, Rev. Proc. 2013-34 should be consulted. This revenue procedure sets out the IRS's requirements for equitable relief under section [66\(c\)](#) of the IRC. They are summarized here.

A requesting spouse must satisfy all of the following threshold conditions to be eligible to submit a request for equitable relief under section [66\(c\)](#) of the IRC. The IRS may relieve a requesting spouse who satisfies all the applicable threshold conditions set forth below of all or part of the income tax liability under section [66\(c\)](#) of the IRC if, taking into account all the facts and circumstances, the IRS determines that it would be inequitable to hold the requesting spouse liable for the income tax liability. The threshold conditions are as follows:

(a) The claim for relief is timely filed

If the requesting spouse is applying for relief from a liability or a portion of a liability that remains unpaid, the request for relief must be made on or before the Collection Statute Expiration Date (CSED). The CSED is the date the period of limitation on collection of the income tax liability expires, as provided in section [6502](#) of the IRC. Generally, that period expires 10 years after the assessment of tax, but it may be extended by other provisions of IRC.

Claims for credit or refund of amounts paid must be made before the expiration of the period of limitation on credit or refund, as provided in [section 6511](#) of the IRC. Generally, that period expires three years from the time the return was filed or two years from the time the tax was paid, whichever is later.

(b) No assets were transferred between the spouses as part of a fraudulent scheme by the spouses

(c) The nonrequesting spouse did not transfer disqualified assets to the requesting spouse

For this purpose, the term "disqualified asset" has the meaning given the term by section [6015\(c\)\(4\)\(B\)](#) of the IRC. If the nonrequesting spouse transferred disqualified assets to the requesting spouse, relief will be available only to the extent that the income tax liability exceeds the value of the disqualified assets. Even if there was a transfer of disqualified assets, the requesting spouse may be eligible for relief if the nonrequesting spouse abused the requesting spouse or maintained control over the household finances by restricting the requesting spouse's access to financial information, or the requesting spouse did not have actual knowledge that disqualified assets were transferred.

(d) The requesting spouse did not knowingly participate in the filing of a fraudulent joint return

(e) The income tax liability from which the requesting spouse seeks relief is attributable (either in full or in part) to an item of the nonrequesting spouse or an underpayment resulting from the nonrequesting spouse's income

If the liability is partially attributable to the requesting spouse, then relief can only be considered for the portion of the liability attributable to the nonrequesting spouse. Nonetheless, the IRS will consider granting relief regardless of whether the understatement, deficiency, or underpayment is attributable (in full or in part) to the requesting spouse if any of the following exceptions apply:

- *Attribution solely due to the operation of community property law* If an item is attributable or partially attributable to the requesting spouse solely due to the operation of community property law, then for purposes of this revenue procedure, that item (or portion thereof) will be considered to be attributable to the nonrequesting spouse.
- *Nominal ownership* If the item is titled in the name of the requesting spouse, the item is presumptively attributable to the requesting spouse. This presumption is rebuttable. For example, Spouse A opens an individual retirement account (IRA) in Spouse B's name and forges Spouse B's signature on the IRA in 2017. Thereafter, Spouse A makes contributions to the IRA and in 2019 takes a taxable distribution from the IRA. Spouse A and Spouse B file a joint return for the 2019 taxable year, but do not report the taxable distribution on their joint return. The IRS later determines a deficiency relating to the taxable IRA distribution. Spouse B requests equitable relief from joint and several liability under section [66\(c\)](#) of the IRC. Spouse B establishes that Spouse B did not contribute to the IRA, sign paperwork relating to the IRA, or otherwise act as if Spouse B were the owner of the IRA. Spouse B, thereby, rebuts the presumption that the IRA is attributable to Spouse B.
- *Abuse* If the requesting spouse establishes that he or she was the victim of abuse prior to the time the return was filed, and that, as a result of the prior abuse, the requesting spouse was not able to challenge the treatment of any items on the return, or was not able to question the payment of any balance due reported on the return, for fear of the nonrequesting spouse's retaliation, the IRS will consider granting equitable relief even though the deficiency or underpayment may be attributable in part or in full to an item of the requesting spouse.
- *Fraud committed by nonrequesting spouse* The IRS will consider granting relief notwithstanding that the item giving rise to the understatement or deficiency is attributable to the requesting spouse, if the requesting spouse establishes that the nonrequesting spouse's fraud is the reason for the erroneous item.

If a requesting spouse who did not file a joint return in a community property state, satisfies the threshold conditions, the IRS will consider whether the requesting spouse is entitled to a streamlined determination of equitable relief under section [66\(c\)](#) of the IRC. If a requesting spouse is not entitled to a streamlined determination because the requesting spouse does not satisfy all the elements, the requesting spouse is still entitled to be considered for relief under the equitable factors. The IRS will make streamlined determinations granting equitable relief under section [66\(c\)](#) of the IRC in cases in which the requesting spouse establishes that the requesting spouse:

- Is no longer married to the nonrequesting spouse;
- Would suffer economic hardship if relief were not granted; and
- Did not know or have reason to know of an item of community income properly includible in gross income, which, under the rules contained in section [879\(a\)](#) of the IRC, would be treated as the income of the nonrequesting spouse.

If a spouse requests relief under section [66\(c\)](#) of the IRC and satisfies the threshold conditions, but does not qualify for streamlined determinations granting relief, the IRS may still grant equitable relief if it is determined that it would be inequitable to hold the requesting spouse liable for the unpaid income tax liability or deficiency.

In determining whether it is inequitable to hold the requesting spouse liable for all or part of the unpaid income tax liability or deficiency, and whether full or partial equitable relief under section [66\(c\)](#) of the IRC should be granted, all the facts and circumstances of the case are to be taken into account. The factors listed below are designed as guides and not intended to comprise an exclusive list. Other factors relevant to a specific claim for relief may also be taken into account in making the determination. In evaluating a claim for relief, no one factor or a majority of factors necessarily determines the outcome. The degree of importance of each factor varies depending on the requesting spouse's facts and circumstances. Abuse or the exercise of financial control by the nonrequesting spouse is a factor that may impact the other factors, as described below. Factors to consider include the following:

- **Marital status**

Whether the requesting spouse is no longer married to the nonrequesting spouse as of the date the IRS makes its determination. If the requesting spouse is still married to the nonrequesting spouse, this factor is neutral. If the requesting spouse is no longer married to the nonrequesting spouse, this factor will weigh in favor of relief. For purposes of this section, a requesting spouse will be treated as being no longer married to the nonrequesting spouse only in the following situations:

- The requesting spouse is divorced from the nonrequesting spouse,
- The requesting spouse is legally separated from the nonrequesting spouse under applicable state law,
- The requesting spouse is a widow or widower and is not an heir to the nonrequesting spouse's estate that would have sufficient assets to pay the tax liability, or
- The requesting spouse has not been a member of the same household as the nonrequesting spouse at any time during the 12-month period ending on the date the IRS makes its determination. For these purposes, a temporary absence (e.g., due to incarceration, illness, business, military service, or education) is not considered separation if the absent spouse is expected to return to the household. See Treas. Reg. § 1.6015-3(b)(3)(i). A requesting spouse is a member of the same household as the nonrequesting spouse for any period in which the spouses maintain the same residence.

- **Economic hardship**

Whether the requesting spouse will suffer economic hardship if relief is not granted. For purposes of this factor, an economic hardship exists if satisfaction of the tax liability in whole or in part will cause the requesting spouse to be unable to pay reasonable basic living expenses. Whether the requesting spouse will suffer economic hardship is determined based on rules similar to those provided in Treas. Reg. § 301.6343-1(b)(4), and the IRS will take into consideration a requesting spouse's current income and expenses and the requesting spouse's assets. In determining the requesting spouse's reasonable basic living expenses, the IRS will consider whether the requesting spouse shares expenses or has expenses paid by another individual (such as a family member, including a current spouse). If denying relief from the joint and several liability will cause the requesting spouse to suffer economic hardship, this factor will weigh in favor of relief. If denying relief from the joint and several liability will not cause the requesting spouse to suffer economic hardship, this factor will be neutral.

In determining whether the requesting spouse would suffer economic hardship if relief is not granted, the IRS will compare the requesting spouse's income to the Federal poverty guidelines (as updated periodically in the Federal Register by the U.S. Department of Health and Human Services under the authority of [42 U.S.C. § 9902\(2\)](#)) for the requesting spouse's family size and will determine by how much, if at all, the requesting spouse's monthly income exceeds the spouse's reasonable



basic monthly living expenses. This factor will weigh in favor of relief if the requesting spouse's income is below 250% of the Federal poverty guidelines, unless the requesting spouse has assets out of which the requesting spouse can make payments towards the tax liability and still adequately meet the requesting spouse's reasonable basic living expenses. If the requesting spouse's income exceeds 250% of the Federal poverty guidelines, this factor will still weigh in favor of relief if the requesting spouse's monthly income exceeds the requesting spouse's reasonable basic monthly living expenses by \$300 or less, unless the requesting spouse has assets out of which the requesting spouse can make payments towards the tax liability and still adequately meet the requesting spouse's reasonable basic living expenses. If the requesting spouse's income exceeds 250% of the Federal poverty guidelines and monthly income exceeds monthly expenses by more than \$300, or if the requesting spouse qualifies under either standard but has sufficient assets to make payments towards the tax liability and still adequately meet the requesting spouse's reasonable basic living expenses, the IRS will consider all facts and circumstances (including the size of the requesting spouse's household) in determining whether the requesting spouse would suffer economic hardship if relief is not granted. If the requesting spouse is deceased, this factor is neutral.

- **Knowledge or reason to know**

Whether the requesting spouse knew or had reason to know of an item of community income properly includible in gross income, which, under the rules contained in section 879(a) of the IRC, would be treated as the income of the nonrequesting spouse.

- **Abuse by the nonrequesting spouse**

If the requesting spouse establishes that he or she was the victim of abuse (not amounting to duress, see Treas. Reg. § 1.6015-1(b)), then depending on the facts and circumstances of the requesting spouse's situation, the abuse may result in certain factors weighing in favor of relief when otherwise the factor may have weighed against relief. Abuse comes in many forms and can include physical, psychological, sexual, or emotional abuse, including efforts to control, isolate, humiliate, and intimidate the requesting spouse, or to undermine the requesting spouse's ability to reason independently and be able to do what is required under the tax laws. All the facts and circumstances are considered in determining whether a requesting spouse was abused. The impact of a nonrequesting spouse's alcohol or drug abuse is also considered in determining whether a requesting spouse was abused. Depending on the facts and circumstances, abuse of the requesting spouse's child or other family member living in the household may constitute abuse of the requesting spouse.

- **Legal obligation**

Whether the requesting spouse or the nonrequesting spouse has a legal obligation to pay the outstanding federal income tax liability. For purposes of this factor, a legal obligation is an obligation arising from a divorce decree or other legally binding agreement. This factor will weigh in favor of relief if the nonrequesting spouse has the sole legal obligation to pay the outstanding income tax liability pursuant to a divorce decree or agreement. This factor, however, will be neutral if the requesting spouse knew or had reason to know, when entering into the divorce decree or agreement, that the nonrequesting spouse would not pay the income tax liability. This factor will weigh against relief if the requesting spouse has the sole legal obligation. The fact that the nonrequesting spouse has been relieved of liability for the taxes at issue as a result of a discharge in bankruptcy is disregarded in determining whether the requesting spouse has the sole legal obligation. This factor will be neutral if, based on an agreement or consent order, both spouses have a legal obligation to pay the outstanding income tax liability, the spouses are not separated or

divorced, or the divorce decree or agreement is silent as to any obligation to pay the outstanding income tax liability.

- **Significant benefit**

Whether the requesting spouse significantly benefitted from the unpaid income tax liability or understatement. See Treas. Reg. § 1.6015-2(d).

A significant benefit is any benefit in excess of normal support. For example, if the requesting spouse enjoyed the benefits of a lavish lifestyle, such as owning luxury assets and taking expensive vacations, this factor will weigh against relief. If, however, the nonrequesting spouse controlled the household and business finances or there was abuse such that the nonrequesting spouse made the decision on spending funds for a lavish lifestyle, then this mitigates this factor so that it is neutral. If only the nonrequesting spouse significantly benefitted from the unpaid tax or understatement, and the requesting spouse had little or no benefit, or the nonrequesting spouse enjoyed the benefit to the requesting spouse's detriment, this factor will weigh in favor of relief. If the amount of unpaid tax or understatement was small such that neither spouse received a significant benefit, then this factor is neutral. Whether the amount of unpaid tax or understatement is small such that neither spouse received a significant benefit will vary depending on the facts and circumstances of each case.

- **Compliance with income tax laws**

Whether the requesting spouse has made a good faith effort to comply with the income tax laws in the taxable years following the taxable year or years to which the request for relief relates.

- If the requesting spouse is compliant for taxable years after being divorced from the nonrequesting spouse, then this factor will weigh in favor of relief. If the requesting spouse is not compliant, then this factor will weigh against relief. If the requesting spouse made a good faith effort to comply with the tax laws but was unable to fully comply, then this factor will be neutral. For example, if the requesting spouse timely filed an income tax return but was unable to fully pay the tax liability due to the requesting spouse's poor financial or economic situation after the divorce, then this factor will be neutral.
- If the requesting spouse remains married to the nonrequesting spouse, whether or not legally separated or living apart, and continues to file joint returns with the nonrequesting spouse after requesting relief, then this factor will be neutral if the joint returns are compliant with the tax laws, but will weigh against relief if the returns are not compliant.
- If the requesting spouse remains married to the nonrequesting spouse but files separate returns, this factor will weigh in favor of relief if the requesting spouse is compliant with the tax laws and will weigh against relief if the requesting spouse is not compliant with the tax laws. If the requesting spouse made a good faith effort to comply with the tax laws but was unable to fully comply, then this factor will be neutral. For example, if the requesting spouse timely filed an income tax return but was unable to fully pay the tax liability due to the requesting spouse's poor financial or economic situation as a result of being separated or living apart from the nonrequesting spouse, then this factor will be neutral.

- **Mental or physical health**

Whether the requesting spouse was in poor physical or mental health. This factor will weigh in favor of relief if the requesting spouse was in poor mental or physical health at the time the return or returns for which the request for relief relates were filed (or at the time the requesting spouse

reasonably believed the return or returns were filed), or at the time the requesting spouse requested relief. The IRS will consider the nature, extent, and duration of the condition, including the ongoing economic impact of the illness. If the requesting spouse was in neither poor physical nor poor mental health, this factor is neutral.

(7) Section 66(c) – Other Concerns

A request for relief that is denied by the IRS may be appealed to the Tax Court. The appeal must be from a statutory notice of deficiency or a collection due process notice. [*Beck v. Commissioner*, T.C. Memo. 2001-198] No appeal may be made solely from a denial of relief under section 66 of the IRC. [*Bernal v. Commissioner*, 120 T.C. 102 (2003)] If an appeal is made under collection due process, the request for relief under section 66(c) of the IRC must be raised administratively before appeal to the Tax Court. Also, if an appeal is brought in Tax Court from a collection due process proceeding, no refund can be issued.

Even if relief under section 66(c) of the IRC is granted, the IRS may still collect from any marital property asset(s). If the IRS attempts to collect from separate assets, you should contact the name listed on the collection notice immediately.

Similarly, no refund will be made from marital assets.

(8) Section 66(b)

A third provision of section 66(b) of the IRC is not an innocent spouse provision. A taxpayer may not rely on it to escape liability for tax on community property income. [*Drummer v. Commissioner*, T.C. Memo 1994-214, aff'd 68 F.3d 472 (5th Cir. 1995) and *Hardy v. Commissioner*, 181 F.3d 1002 (9th Cir. 1999).] The IRS may invoke it at its discretion. Under it, the IRS may require a spouse to report 100% of an item of community property.

Section 66(b) of the IRC applies if the item was treated by the spouse as if he or she were solely entitled to the income, and 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).

The first requirement has been interpreted to mean that the spouse retained the item of income for himself or herself. [Compare *Cox v. Commissioner*, T.C. Memo 1993-559 (holding section 66(b) of the IRC did not apply where the funds were deposited into a joint bank account) with *McPherson v. Commissioner*, T.C. Memo 1991-520 (holding section 66(b) of the IRC did apply where spouse retained their own earned income for himself).] The notice requirement is self-explanatory. A spouse can avoid the application of section 66(b) of the IRC, for example, by providing the other spouse with copies of 1099 or W-2 Forms, income statements for businesses, or other equivalent documents.

(9) Filing Returns and Uncooperative Spouses

Where section 66 of the IRC applies, spouses must follow its requirements. Where section 66 of the IRC does not apply, spouses filing separate returns must report community property income and deductions correctly by splitting them between their returns. Failure to do so could result in the assessment of additional tax and penalties. Spouses may not simply ignore community property filing requirements. Spouses may only deviate from a legal requirement to split community property income where it is impossible to obtain the necessary information. Generally this occurs where one spouse refuses to cooperate or is unavailable.

**Example:** Spouse A and Spouse B are married but separated at the end of 2021. Spouse A refuses to share with Spouse B any information concerning the amount of Spouse A's wages or other income. In these circumstances, Spouse B should conform to the following procedures. Spouse B should notify Spouse A of

the amount and nature of Spouse B's income and deductions. Spouse B should request from Spouse A the same information in return. If Spouse A does not provide the needed information, Spouse B should then report income, deductions, and individual withholding, ignoring community property law principles (i.e., Spouse B should report and pay the tax on 100% of the income earned or produced by Spouse B). Spouse B should attach a [Form 8275, Disclosure Statement](#), to Spouse B's return. The disclosure statement should state that although Spouse B may be responsible for reporting marital property income that is not shown on the return, income, deductions, and tax payments are being reported on a common law basis because it is impossible to determine the community income share.

If the IRS subsequently audits Spouse B's return and determines that Spouse B qualifies under section 66 of the IRC, no changes would have to be made to the return. However, if Spouse B does not qualify for relief under section 66 of the IRC, the IRS could, nevertheless, recalculate the tax due using community property principles. Assuming Spouse B provided a complete and accurate statement of income and deductions to Spouse A before the return due date, Spouse B can establish that Spouse B did not have access to Spouse A's return information, and Spouse B included a Form 8275 with Spouse B's return, no penalties will be assessed against Spouse B or Spouse B's return preparer for failing to report half of Spouse A's Wisconsin marital property income. This procedure only applies to the limited circumstances described above. Taxpayers who deliberately ignore marital property filing requirements and do not disclose needed tax information to the other spouse risk penalties or invocation of section 66(b) of the IRC on the affected return items.

#### (10) Retroactive Divorce Decrees

Divorce decrees may not be used to retroactively reclassify income to avoid community reporting requirements. [*Daine v. Commissioner*, 168 F.2d 449 (2d Cir. 1948); Cf. *Brent v. Commissioner*, 630 F.2d 356, 361 (5th Cir. 1980).] These provisions in divorce decrees will only be honored prospectively. Also, some divorce decrees purport to require spouses to ignore federal laws concerning the reporting of community property income. Taxpayers following these provisions risk having penalties assessed against them. Attorneys drafting such provisions could also be subject to penalties. [See IRC sec. 6694, Treas. Reg. § 301.7701-15(b).]

#### Wisconsin Treatment

Wisconsin does not follow the federal "living apart all year" rule found in section [66\(a\)](#) of the IRC. Although the Department of Revenue had proposed that a similar Wisconsin rule be included in the marital property trailer bill, the Legislature's Special Committee on Marital Property Implementation rejected this approach because the Wisconsin Marital Property Act applies to spouses until the dissolution of the marriage. Instead, the Legislature created a much broader Wisconsin "innocent spouse" rule [sec. [71.10\(6\)\(b\)](#), Wis. Stats.], which states:

A spouse filing a separate return may be relieved of liability for the tax, interest, penalties, fees, additions to tax and additional assessments under this chapter in the manner specified in section [66\(c\)](#) of the Internal Revenue Code. The department may not apply ch. [766](#) in assessing a taxpayer with respect to marital property income the taxpayer did not report if that taxpayer failed to notify the taxpayer's spouse about the amount and nature of the income before the due date, including extensions, for filing the return for the taxable year in which the income was derived. The department shall include all of that marital property income in the gross income of the taxpayer and exclude all of that marital property income from the gross income of the taxpayer's spouse.

Substantially the same treatment applies for formerly married and remarried persons. [Sec. [71.10\(6m\)\(a\)](#), Wis. Stats.]

A person who seeks relief from liability under the provisions on the previous page must apply for relief with the department within two years after the date on which the department first begins collection activities. [Secs. [71.10\(6\)\(e\)](#) and [71.10\(6m\)\(c\)](#), Wis. Stats.]

Wisconsin adjusted gross income is defined as federal adjusted gross income as determined under the IRC in effect for Wisconsin purposes, with certain modifications. [See secs. [71.01\(13\)](#) and [71.05\(6\)](#) to [\(12\)](#), [\(19\)](#), [\(20\)](#), [\(24\)](#), [\(25\)](#), [\(25m\)](#) and [\(26\)](#), Wis. Stats.] Among the required modifications are additions to or subtractions from federal adjusted gross income, as appropriate, for the amount necessary to reflect:

- The inapplicability of the federal "living apart all year" rule (sec. [66\(a\)](#) of the IRC),
- The applicability of the Wisconsin rules regarding "innocent spouses," marital property agreements, and part-year residents and nonresidents of Wisconsin (sec. [71.10\(6\)\(b\)](#) to [\(d\)](#), Wis. Stats.), and
- Any other differences between the treatment of marital income for federal income tax purposes and the treatment of marital income for Wisconsin income tax purposes.

[Sec. [71.05\(10\)\(f\)](#), [\(g\)](#), and [\(h\)](#), Wis. Stats.]

Under the Wisconsin "innocent spouse" statute, the burden is on the earner spouse to notify the nonearning spouse about the amount and nature of marital property income. If the nonearning spouse isn't notified, he or she is an "innocent spouse" with respect to that marital property income. The statute provides that notification is timely only if made by the due date, including extensions, for filing the earner spouse's tax return. This timing for notification may cause a hardship for the nonearning spouse when the earner spouse delays notification to the last day or obtains an extension. Nevertheless, the nonearner will have to file an amended return to report the additional income. [*Joyce A. Bennett v. Wisconsin Department of Revenue*, W.T.A.C., Docket No. 88-I-542 (November 15, 1989).]

Section [71.10\(6\)\(b\)](#), Wis. Stats., does not require the earner spouse to make notification for income tax purposes. If the earner spouse doesn't provide notification about the nature and amount of marital property income over which he or she had control, the earner spouse must report all of that marital property income. Thus, failure to make notification may result in treatment similar to that provided in the federal "living apart all year" rule or to that available if the spouses had signed a marital property agreement to classify their income as individual property. By not making notification, each spouse would be an innocent spouse with respect to the other's marital property income. It should be noted that the spouse with the higher income will pay additional tax as a result and, therefore, may notify in order to secure the income-splitting benefit. Consequently, a spouse who doesn't provide notification may be taxed on more than half of the couple's total marital property income. The spouses may wish to enter into an agreement that neither spouse will provide notification; however, such an agreement would not be binding on the Department of Revenue should one spouse violate the agreement and make notification.

The following example illustrates the problem that may arise.

**Example:** Spouse A and Spouse B are married. Spouse B doesn't notify Spouse A about the marital property income Spouse B's services and property produced but instead reports the entire amount on a separate return filed before the April 15 due date. After filing the return, Spouse B receives notification about the nature and amount of the marital property income Spouse A's services and property produced. Provided Spouse A's notification is timely, Spouse B must amend Spouse B's return and report one-half of the marital property income Spouse A's services and property produced. If Spouse A notifies before April 15, there is the possibility that Spouse B may still notify Spouse A by April 15 of the nature and amount of Spouse B's marital property income and report one-half of the combined marital property income on an amended return. However, if Spouse A has an extension to file until October 15 and provides notification on October 1, Spouse B cannot then notify Spouse A about Spouse B's marital property income since it is after

the due date of Spouse B's return. Thus, Spouse B must file an amended return reporting all of Spouse B's marital property income and one-half of Spouse A's marital property income, whereas Spouse A would report one-half of Spouse A's marital property income.

In addition, the statute doesn't specify how notification is to be made. Due to opposition from the Legislature's Marital Property Implementation Committee, the department had to abandon its attempt to promulgate an administrative rule concerning notification. It was felt that a rule would unduly limit the innocent spouse protection and that it would be better to let the courts determine whether notification was sufficient under the facts of a particular situation. Therefore, the Department of Revenue has no guidance for determining whether proper notification has taken place and will issue assessments in the alternative when a problem arises.

If the nonearning spouse disputes that notification occurred, the earner spouse should be prepared to prove when notification was made, what it consisted of, and how it was accomplished. Although the department cannot state that either of the following two methods is adequate notice, it appears that (1) notification made by mail may be evidenced by sending it by certified mail, return receipt requested, and retaining a copy of what was sent, and (2) notification made in person could be done in front of a disinterested person who signs an affidavit with a copy of the income information attached. In addition, although the department cannot state what the notice must contain, it probably isn't sufficient to give just a total dollar amount of income, since the spouse won't know how to report it. The department believes that sufficient information to file a tax return is the "goal" of notification.

The notification of marital property income and failure to notify about expenses, deductions, and withholding related to that income will not enable the earner spouse to claim the entire amount of those items. Certain negative income items must be allocated in the same manner as the income is or would be allocated, and a similar rule applies for withholding. [See secs. [71.01\(16\)](#) and [71.64\(1\)\(c\)](#), Wis. Stats.] Such incomplete notification may result in the conclusion that no notification took place and the earner spouse must report all of the marital property income.

Whenever it is apparent to the department that there is a dispute as to whether notification has occurred, the department will issue assessments in the alternative. For example, if the earner spouse reports one-half of the marital property income their property and services produced and the nonearning spouse fails to report the other half, the department will issue assessments in the alternative, which will reflect more than the total income of both spouses. The earner spouse will be assessed tax on 100% of the income their property and services produced, thus denying that proper notification occurred. The nonearner will be assessed tax on one-half of that income, thus denying that spouse's claim to be an innocent spouse. Upon final determination of the proper income reporting, the department will adjust either or both spouses' incomes, expenses, and deductions, as appropriate. The purpose of assessments in the alternative is to have the spouses mutually agree on the facts of notification.

The following example further illustrates assessments in the alternative.

**Example:** Spouse A and Spouse B are married. Spouse A's efforts produce \$50,000 of wages, and Spouse A has \$3,000 of Wisconsin tax withheld. Spouse B's efforts produce \$14,000 of wages, and Spouse B has \$700 of Wisconsin tax withheld. Spouse A claims to have notified Spouse B about Spouse A's wages but Spouse B claims that Spouse B wasn't notified. The spouses agree that Spouse B didn't notify Spouse A about the amount of Spouse B's wages. On Spouse A's Wisconsin return, Spouse A reports \$25,000 of wages and claims \$1,500 of withholding. On Spouse B's Wisconsin return, Spouse B reports \$14,000 of wages and claims \$700 of withholding.

The department will issue assessments in the alternative, as follows:

Spouse A will be assessed the tax on \$50,000 of wages (all of Spouse A's wages) and will be allowed credit for \$1,500 of withholding (one-half of Spouse A's withholding). Spouse B will be assessed the tax on \$39,000 of wages (all of Spouse B's wages and one-half of Spouse A's wages). Spouse B will be allowed credit for \$700 of withholding (all of Spouse B's withholding). After the Tax Appeals Commission determines whether proper notification was made, the assessments will be adjusted accordingly. The notification issue may also be resolved between the spouses by agreement, thus avoiding a hearing on the issue.

### Comparison of Federal and Wisconsin Innocent Spouse Treatment

Suppose that Spouse A and Spouse B are married, and their determination date is January 1, 1986. Spouse A's efforts produce \$40,000 of wages. Stocks gifted to Spouse A in 1992 as individual property produce \$1,000 of dividend income. Spouse B operates a business which generates \$10,000 of income. In addition, a corporate bond Spouse B inherited in 1996 produces \$500 of interest income, and real estate Spouse B inherited in 1996 produces net rental income of \$1,500. All of the income is marital property. Their income would be reported as follows:

	<b>Federal Returns</b>			
	<i>If Sec. 66(a) of the IRC Applies</i>		<i>If Sec. 66(a) of the IRC Does Not Apply</i>	
	Spouse A	Spouse B	Spouse A	Spouse B
Wages	\$40,000	\$ 0	\$20,000	\$20,000
Interest	0	500	250	250
Dividends	1,000	0	500	500
Business income	0	10,000	5,000	5,000
Net rental income	<u>0</u>	<u>1,500</u>	<u>750</u>	<u>750</u>
Total income reported	\$41,000	\$12,000	\$26,500	\$26,500

	<b>Wisconsin Returns</b>			
	<i>If Neither Spouse Notifies</i>		<i>If Both Spouses Notify</i>	
	Spouse A	Spouse B	Spouse A	Spouse B
Wages	\$40,000	\$ 0	\$20,000	\$20,000
Interest	0	500	250	250
Dividends	1,000	0	500	500
Business income	0	10,000	5,000	5,000
Net rental income	<u>0</u>	<u>1,500</u>	<u>750</u>	<u>750</u>
Total income reported	\$41,000	\$12,000	\$26,500	\$26,500

	<b>Wisconsin Returns</b>			
	<i>If Only Spouse A Notifies</i>		<i>If Only Spouse B Notifies</i>	
	Spouse A	Spouse B	Spouse A	Spouse B
Wages	\$20,000	\$20,000	\$40,000	\$ 0
Interest	0	500	250	250
Dividends	500	500	1,000	0
Business income	0	10,000	5,000	5,000
Net rental income	<u>0</u>	<u>1,500</u>	<u>750</u>	<u>750</u>
Total income reported	\$20,500	\$32,500	\$47,000	\$ 6,000

## C. Estimated Tax Payments

### Federal Treatment

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:

<u>Separate Tax Liability</u>		Estimated
Both Tax Liabilities	X	Tax Payments

[Rev. Rul. 80-7, 1980-1 C.B. 296, *amplified* by Rev. Rul. 87-52, 1987-1 C.B. 347; Treas. Reg. 1.6654-2(e)(5)(ii)(B); *United States v. Johnson*, 75-1 U.S.T.C. ¶ 9144, 35 A.F.T.R.2d ¶ 75-490 (D. Minn. 1974).] If the spouses file a joint return and the character of the estimated tax payment becomes material (*e.g.*, for an injured spouse claim under section 6402 of the IRC), the source of the payment is considered. [*Elam v. United States*, 112 F.3d 1036 (9th Cir. 1997).]

### Wisconsin Treatment

Wisconsin's estimated tax statutes are patterned after the federal regulations and court decisions. If married persons file a joint return, it makes no difference whether they have made joint or separate estimated tax payments, as the full amount may be claimed. However, difficulties do arise if married persons file separate Wisconsin returns. On separate returns, joint estimated tax payments can be divided any way that the spouses choose. If the spouses can't agree, the department will divide the payments in proportion to the tax liability shown on the separate returns. [Sec. [71.09\(16\)](#), Wis. Stats.] If spouses make separate estimated tax payments, no part of the payment may be allocated to the other spouse. [Sec. [71.09\(16\)](#), Wis. Stats.] Withholding, as previously indicated, must be allocated in the same way that the income is or would be reported. [Sec. [71.64\(1\)\(c\)](#), Wis. Stats.]

## D. Marital Property Agreements

### Federal Treatment

The IRS will recognize the validity of marital property agreements for federal income tax reporting purposes if they provide that any future income earned by either spouse for personal services will be the individual property of that spouse, rather than the marital property income of both spouses. It is even possible to have such agreements provide that a percentage of what would normally be marital property income would be considered individual property. However, never more than 50% of the total marital property income can be reclassified as the income of the nonearner spouse.

By way of an example, assume that one spouse has \$10,000 of earned income and the other spouse has no income. The nonearning spouse is entitled to \$5,000 of this earned income as their share of marital property. Suppose, however, that to take advantage of tax deductions that might otherwise be missed, the spouse earning income chooses to execute a marital property agreement assigning more than \$5,000 to the nonearning spouse. The IRS would not recognize such an agreement because it involves the contracting away of property that was not owned by the wage earner because he or she is only entitled to 50% of the earned income under the Marital Property Act.



Provisions are also made under the Marital Property Act to allow parties to "opt out" of the Act for prescribed periods. Earlier legislation permitted this on a one-year basis (a statutory individual property classification agreement that expired January 1, 1987). [Sec. [766.587](#), Wis. Stats.] Subsequent trailer bill legislation added a provision permitting the "opt out" for a three-year period (a statutory terminable marital property classification agreement). [Sec. [766.589](#), Wis. Stats.] Another provision under the Marital Property Act allows a spouse who owns individual property that generates income to give a unilateral statement to the other spouse advising the other spouse that the income is not marital property. [Sec. [766.59](#), Wis. Stats.] Although the IRS recognizes these agreements and unilateral statements for federal tax reporting purposes, they do have their limitations which are discussed under the sections on divorce, basis, and delinquent taxes. The enabling statute prescribes notice requirements on these agreements in terms of altering creditor rights. The IRS does not prescribe a notice requirement and will accept marital property agreements at the time of taxpayer contact for income reporting purposes. The marital property agreement will only be recognized prospectively from the date it was executed. The IRS does not recognize retroactive reclassification agreements.

For reasons discussed in the sections on divorce and delinquent taxes, it is generally a good idea to serve a copy of the agreement on the IRS at the time it is executed. These agreements should be mailed to the following address:

Internal Revenue Service  
SB/SE Advisory, Stop 5303 MIL  
211 W. Wisconsin Avenue  
Milwaukee, WI 53203

A marital property agreement may not be effective to change the character of income that has already been received or earned from marital property to individual property, retroactively, for federal income tax reporting purposes.

As will be seen in Part 5, the IRS does prescribe a notice requirement with regard to honoring marital property agreements in the context of collecting delinquent taxes. The notice rules with regard to marital property agreements are different in the area of collection of federal taxes.

### **Wisconsin Treatment**

For Wisconsin income tax purposes, as well as federally, spouses cannot use a marital property agreement to retroactively reclassify income previously received, whether from marital property income to individual income or vice versa, and a court may not order such a retroactive reclassification either. An agreement may classify income received only from the date of signing forward.

There are several important differences between the federal and Wisconsin treatment of marital property agreements:

- The Department of Revenue, unlike the IRS, will recognize an agreement which allocates more than half of the marital property income to the nonearning spouse.
- The Department of Revenue isn't bound by any marital property agreement or unilateral statement not provided to the department before the issuance of an assessment. [Sec. [71.10\(6\)\(c\)](#), Wis. Stats.]
- Such an agreement or statement isn't effective for state purposes for any time that both spouses aren't domiciled in Wisconsin. [Sec. [71.10\(6\)\(c\)](#), Wis. Stats.]
- Such agreements or statements don't affect claims for refund. [Sec. [71.75\(6\)](#), Wis. Stats.]

- A marital property agreement or unilateral statement can't be used in computing income, property taxes accrued, or rent constituting property taxes accrued for homestead credit purposes. [Sec. [71.52\(6\)](#), [\(7\)](#), and [\(8\)](#), Wis. Stats.]

Since the Department of Revenue isn't bound by any marital property agreement not provided to the department before the issuance of an assessment or billing, spouses may want to send a copy of any agreement to the department at the time it is executed. Include both spouses' social security numbers and send marital property agreements to the following address:

Mail Stop 5-144  
Wisconsin Department of Revenue  
Billing and Audit Support  
P.O. Box 8906  
Madison, WI 53708-8906

Note that the department does not acknowledge the receipt of unsolicited agreements and does not review them.

## E. Divorce

### Federal Treatment

The tax impact of the Marital Property Act takes on a severe implication in those situations in which a divorce action is pending, with the spouses separated and living apart. Except for the innocent spouse provisions and section [66](#) of the IRC, discussed under income reporting, little is available to ameliorate the difficulties encountered when spouses do not communicate tax information. Because of the requirement that marital property income be equally divided, there is often a taxing of income to one spouse even though he or she did not receive the income. In essence, even though the parties are separated, living apart, and not communicating, the marital property statute (sec. [766.01](#), Wis. Stats.) provides that the marital property estate can be dissolved only through divorce, annulment, or a decree of legal separation or separate maintenance. This means that absent a marital property agreement, which is only prospective in nature, the parties must report their respective shares of marital property income even though a divorce petition has been filed.

Since enactment of the Marital Property Act, divorce litigants have attempted, through a marital property agreement, to reclassify income in the year of decree or in the year in which a petition is filed into individual income versus marital property income. Undoubtedly, this recharacterization of income would be the easiest way to handle an already difficult situation. Regrettably, this is not possible since the marital property income was already actually or constructively received. A decree or marital property agreement that attempts to reclassify income as individual property retroactively will only be honored from the date it is signed for federal income tax purposes. [*Cf.*, *Daine v. Commissioner*, 168 F.2d 449 (2nd Cir. 1948) and *Brent v. Commissioner*, 630 F.2d 356, 361 (5th Cir. 1980).]

This situation is compounded further by the fact that the parties, in the year in which the decree is rendered, would have income for a portion of the year reportable as marital property income and for the portion of the year subsequent to the decree reportable as income of the spouse who earned it. There are a few solutions to this dilemma. One is to have a marital property agreement take effect at the beginning of the next tax year after the petition is filed which will then be effective until the divorce decree is entered; another is to have the decree rendered on December 31, which would make the entire prior year subject to marital property income reporting.

The following example illustrates the tax reporting problems confronting spouses undergoing a divorce:

**Example:** For this illustration assume Spouse A and Spouse B are divorced. The divorce decree was rendered on March 31. Spouse A earned a total of \$48,000 in income and had \$8,000 in federal income tax withholding. Spouse B earned \$18,000 and had \$4,000 withheld for federal income tax. There is no marital property agreement.

In this situation, all income earned before March 31 is marital property. All income earned after March 31 is the property of the spouse who earned it. Since Spouse A and Spouse B were married for three months, 3/12 of the income earned by each should be split and reported by the other spouse, and 9/12 should be reported by the spouse who earned it.

Therefore, income should be reported as follows:

	Total	Spouse B's Share	Spouse A's Share
3/12 Spouse B's wages (marital property share)	\$ 4,500	\$ 2,250	\$ 2,250
3/12 Spouse A's wages (marital property share)	12,000	6,000	6,000
9/12 Spouse B's wages	13,500	13,500	-0-
9/12 Spouse A's wages	<u>36,000</u>	<u>-0-</u>	<u>36,000</u>
Total to be reported	\$66,000	\$21,750	\$44,250

Federal withholding credits should be claimed as follows:

	Total	Spouse B's Share	Spouse A's Share
3/12 Spouse B's withholding (marital property share)	\$ 1,000	\$ 500	\$ 500
3/12 Spouse A's withholding (marital property share)	2,000	1,000	1,000
9/12 Spouse B's withholding	3,000	3,000	-0-
9/12 Spouse A's withholding	<u>6,000</u>	<u>-0-</u>	<u>6,000</u>
Total withholding	\$12,000	\$ 4,500	\$ 7,500

Of course, the above example assumes that both spouses are employees and their earnings are relatively constant. Dividing income by the number of months (or days, if appropriate) would approximate the actual amount of money earned before and after the divorce. If, however, either spouse's earnings vary during the year, the division would have to be made based on how much money was actually earned prior to and after the divorce.

As you can see in the example above, in the year of divorce Spouse A ends up with less income and withholding than Spouse A's W-2 Form indicates, and Spouse B ends up with more income and withholding. Again, as in the situation with "married filing separately," these individuals, who will likely be filing single returns in the year of divorce, *must* attach some form of explanation, preferably [Form 8958, Allocation of Tax Amounts Between Certain Individuals in Community Property States](#), which reconciles the discrepancy of their tax returns with the amount reported to the IRS. The form should indicate the date on which the divorce decree was entered. It is not necessary to attach a copy of the decree.

### Wisconsin Treatment

For Wisconsin purposes as well as for federal purposes, income earned by spouses after they separate but prior to the date of divorce continues to be marital property and must be treated as such on their income tax returns. The federal example of how income and withholding, up to the date of divorce, is allocated also applies for Wisconsin purposes. The only exceptions to this treatment are if (1) the spouses entered into a marital property

agreement at the time of separation to classify the income subsequently received as the individual income of the recipient, or (2) the innocent spouse rule in sec. [71.10\(6\)\(b\)](#) or [\(6m\)\(a\)](#), Wis. Stats., applies.

Caution must be exercised in the drafting of marital property agreements since the department won't recognize agreements which retroactively reclassify income. An agreement which states that in the year a divorce is granted the income of the spouses will be individual income, is still retroactive since the granting of the divorce decree is what triggers the classification of income received before the decree is granted. If a future event is to trigger the reclassification of income, that event must occur before the income is generated. For example, an agreement that provides that all income received after the filing of a petition for divorce will be the individual income of the earner spouse would be acceptable, provided that the agreement is signed before the income is earned.

The innocent spouse rule for persons who will file individual returns for the year of divorce is the same as the notification rule previously discussed for separate returns. It must be remembered that the innocent spouse rule doesn't reclassify marital property income to individual income for purposes of determining whether alimony is deductible by the payer spouse and taxable to the recipient (see Part F on page 28). In divorce situations, the question arises as to whether the disclosure of income in the divorce proceedings is adequate notification. Since the courts have not issued any opinions in this area, the department is unable to provide any guidance. The department suggests that the spouses' accountants and/or attorneys try to get the spouses to agree on whether they will or will not notify each other of the amount and nature of their marital property income.

## F. Alimony or Separate Maintenance

### Federal Treatment

Beginning on January 1, 2019, any divorce agreement providing for the payment of alimony no longer has a tax effect on the payor or payee's tax return. Under the Tax Cut and Jobs Act, for divorce agreements entered into after December 31, 2018, the payor of the alimony no longer is allowed to claim a deduction for the payment and the payee (or recipient) of the alimony no longer has to include the alimony on their tax return as income.

For divorce agreements entered into before December 31, 2018, those agreements have been grandfathered and the alimony payments are still deductible to the payor and includable in income for the payee. [I.R.C. secs. [71](#) and [215](#)].

### Wisconsin Treatment

Wisconsin's treatment of alimony or separate maintenance income and deductions is the same as the federal treatment described above. Since the innocent spouse rule doesn't change the classification of property, it doesn't affect Wisconsin's treatment of alimony or separate maintenance income and deductions.

## G. Payment of Taxes

### Federal Treatment

When the marital estate is divided pursuant to a divorce decree, provisions are sometimes made for the payment of federal income tax. Generally, these provisions will provide that one spouse is responsible to pay any taxes owed the last year a joint income tax return was filed. Typically, joint returns are filed pending the divorce action since those tax rates are more favorable than the married filing separate rates. Caution needs to be exercised in this area because those decrees affixing federal income tax responsibilities are not binding upon the IRS. In the situation involving a joint return, the tax liability is joint and several. Therefore, the IRS will enforce collection against either party and leave the compliance with the decree provision as a matter for the spouses, or former spouses, to resolve with the State Court. The best course of action for divorcing spouses is to ensure

that these taxes are paid with the filed return or to verify, before the decree is rendered, that the joint tax return liability has been satisfied. Either spouse can authorize a disclosure of joint return information to their power of attorney, and the easiest way to secure this information is by signing a [Form 8821](#), *Tax Information Authorization*, which will permit the IRS to disclose whether all payments have been made.

In a pre-divorce situation where the spouses file a joint return, the only relief available would be the "innocent spouse" provisions of the IRC. For more information see IRS Publication 971.

### Wisconsin Treatment

Married persons who file a joint Wisconsin income tax return are jointly and severally liable for the tax due, the same as for federal purposes. However, unlike for federal purposes, a judgment of divorce affixing state income tax liabilities is binding on the Department of Revenue. The judgment must have been entered on or after June 21, 1996. A copy of that portion of the judgment of divorce that relates to the apportionment of tax liability must be provided to the department.

Additionally, a spouse may be relieved of liability on a joint Wisconsin return in the manner specified in sec. [6015\(a\)](#) to [\(d\)](#) and [\(f\)](#) of the IRC. A spouse who seeks relief from liability under these provisions must apply for relief with the department within two years after the date on which the department first begins collection activities after July 27, 2005. [Secs. [71.10\(6\)\(a\)](#) and [\(e\)](#), Wis. Stats.]

## H. Deductions

As was the case of joint income reporting and the election to file a joint return, the Marital Property Act creates no new problems for claiming income tax deductions. However, there is some impact for deductions in the case of income reporting under the married filing separate status. Following are the rules for claiming deductions:

### (1) Itemized Deductions

#### Federal Treatment

Itemized deductions not associated with specific income (e.g., medical, charitable contributions, state taxes) are generally considered paid from marital property (community funds) and deductible half by each spouse, unless it can be shown that they were paid from individual property (separate funds), in which case they are deductible by the spouse who paid them. [*Clemens v. Commissioner*, 8 T.C. 121, 125 (1947).]

Itemized deductions associated with marital property income (e.g., employee business expenses) are equally divided. [*Stewart v. Commissioner*, 35 B.T.A. 406, 410 (1937), *aff'd.*, 95 F.2d 821 (5th Cir. 1938).] Deductible expenses associated with income that is individual property are deductible by the spouse who owns or earned the income, provided that spouse paid the expenses from their individual property.

#### Wisconsin Treatment

Although itemized deductions cannot be claimed for Wisconsin purposes, certain itemized deductions may be used in the computation of Wisconsin's itemized deduction credit. The Wisconsin treatment of expenses allowed in the computation of the itemized deduction credit is the same as the federal treatment of these expenses. Expenses incurred to earn or produce *marital* property income are generally divided equally between the spouses. Expenses incurred to earn or produce individual income are allocated to the spouse who owns the income, provided that spouse paid the expenses from their individual property. Expenses that aren't attributable to any specific income, such as medical expenses or charitable contributions, are deductible by the spouse who pays them. However, if these personal expenses are paid from marital property funds, then the amounts are divided equally between the spouses.

## (2) Exemptions for Dependents

### Federal Treatment

A single dependency exemption deduction cannot be divided between spouses, although if spouses are entitled to more than one dependency exemption, they can allocate whole exemptions between them.

### Wisconsin Treatment

An exemption deduction is provided for each person for whom the taxpayer is entitled to an exemption under section [152](#) of the IRC. The Wisconsin treatment is the same as the federal treatment. When more than one dependent is supported with marital property funds, the spouses may divide the number of dependents between themselves on separate returns in any manner they choose. No division of a single dependency exemption deduction is allowed.

## (3) Casualty Loss Deductions

### Federal Treatment

This retains the same character as the property that was subject to the loss. If it was a marital property asset that was destroyed through fire or theft, or other sudden unexpected events, then the deduction would be equally divided. [*Kamins v. Commissioner*, 54 T.C. 977 (1970).]

### Wisconsin Treatment

The loss retains the same character as the property that was subject to the loss, the same as federally.

## (4) Bad Debt Deductions

### Federal Treatment

Bad debt deductions are generally split if the money was loaned during the marriage from marital property. However, bad debt deductions for premarital loans are not split if they go bad after marriage. [*Thorman v. Commissioner*, 8 T.C.M. (CCH) 653 (1949).] Payment of a post-marital loan guarantee that is an obligation of the marital community is split. [*Kleberg v. Commissioner*, 43 B.T.A. 277 (1941).]

### Wisconsin Treatment

The federal treatment of bad debt deductions also applies for Wisconsin purposes.

## (5) Deductions for Contributions to Traditional IRAs

### Federal Treatment

The right to this deduction is predicated upon *earned* income; therefore, the payment into a separate IRA could only be claimed on the spouse's return to the extent of IRA limitations imposed, e.g., cap on adjusted gross income. In other words, if there is a nonworking spouse, half of the marital property income earned by the other spouse could not be reported on the nonworking spouse's separate return in order to claim an IRA deduction.

Because contributions to Roth IRAs and education IRAs are not deductible, the discussion above does not apply to contributions to them. For more information on IRAs, see IRS [Publication 590-A](#), *Contributions to Individual Retirement Arrangements (IRAs)*.

**Wisconsin Treatment**

The deduction on separate returns for contributions to an IRA is allocated in the same manner that the related income is reported.

**Example:** Spouse A contributes \$2,000 to Spouse A's IRA based on Spouse A's wages of \$20,000. Spouse B contributes \$1,000 to Spouse B's IRA based on Spouse B's wages of \$18,000. Assuming each spouse notifies the other spouse of marital property income, each spouse will report one-half (\$19,000) of wage income on their separate return. For Wisconsin tax purposes, each spouse may claim an IRA deduction of \$1,500 (one-half of \$3,000).

**(6) Charitable Deductions****Federal Treatment**

If separate returns are filed, the charitable contribution should be split, unless the deduction was paid with the individual property of a spouse, in which case that spouse would be entitled to the entire deduction.

**Wisconsin Treatment**

The federal treatment of charitable gifts also applies for Wisconsin purposes.

**(7) Business Expenses****Federal Treatment**

Generally, income associated with a Schedule C business is marital property, even if the assets of the business are individual property. Business expense deductions associated with generating the marital property income should be classified consistent with the income and split. [*Stewart v. Commissioner*, 35 B.T.A. 406, 410 (1937), *aff'd.*, 95 F.2d 821 (5th Cir. 1938).] Deductible expenses associated with income that is individual property are deductible by the spouse who owns or earned the income, provided that spouse paid the expenses from their individual property.

**Wisconsin Treatment**

Wisconsin follows the federal treatment of business expenses.

**I. Self-Employment Taxes****Federal Treatment**

There are no unique problems created by the Marital Property Act with regard to self-employment taxes if joint returns are filed. However, where separate returns are filed, a determination must be made as to which spouse is liable for the self-employment tax.

*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. [Treas. Reg. 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 management and control imputed from spouse to spouse under community property laws. [Treas. Reg. 1.1402(a)-8.] Therefore, the self-employment tax is imposed on the spouse actually carrying on the trade or business.

**Example:** Spouse A owns and operates a restaurant as a sole proprietorship. The net profit of the restaurant is \$46,000. Spouse A and Spouse B file separate returns. Each spouse would report \$23,000 for income tax purposes. However, Spouse A would be liable for the entire amount of self-employment tax on the \$46,000. Spouse B would not report any self-employment income. Each Schedule SE should indicate that it is being prepared under the requirements of state marital property law to avoid confusion by the IRS in processing the return.

*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. [Treas. Reg. 1.1402(a)-8(b).] If both spouses are partners, the self-employment tax is allocated based on their distributive share. [Treas. Reg. 1.1402(a)-8(b).]

### Wisconsin Treatment

The self-employment tax provisions do not apply for Wisconsin.

## J. Earned Income Credit

### Federal Treatment

Community property income splitting is disregarded in calculating the amount of earned income for purposes of the earned income credit. [I.R.C. § [32\(c\)\(2\)\(B\)\(i\)](#).] However, community property splitting is considered in determining adjusted gross income for purposes of income limitations under I.R.C. §§ [32\(a\)\(2\)](#) and [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. [I.R.C. § [32\(a\)\(2\)\(B\)](#).]

### Wisconsin Treatment

The Wisconsin earned income credit is a percentage of the federal earned income credit, based on the number of qualifying children.

**Caution** Wisconsin has **not** adopted the following changes to the 2021 federal earned income tax credit made by Public Law 117-2. If any of these federal provisions apply, you must recompute your federal earned income tax credit for Wisconsin purposes. Use either Worksheet A or Worksheet B in the 2021 Form 1040 instructions to recompute your federal earned income tax credit for Wisconsin. Enter the recomputed federal credit on line 26 of Form 1 or line 59 of Form 1NPR.

- If your earned income for 2021 is less than your earned income for 2019, you may elect to use your 2019 earned income to compute your 2021 federal earned income tax credit. For Wisconsin, you must use your 2021 earned income to compute your federal earned income tax credit.
- Raised the investment income limit to \$10,000. For Wisconsin, the investment income limit is \$3,650.
- Allows a married individual filing as married filing separate to claim the earned income tax credit if either of the following apply:
  - The individual lived apart from their spouse for the last 6 months of 2021.
  - The individual has a decree of divorce or separate maintenance, a written separation agreement, or a decree requiring a spouse to make payments for the support or maintenance of the other spouse and does not live with the other spouse at the end of 2021.

For Wisconsin, a married individual filing as married filing separate cannot claim the earned income tax credit



if either of these situations apply.

A married couple who claims the federal earned income credit on a joint federal return may also claim the Wisconsin earned income credit on a joint Wisconsin return if they have at least one qualifying child and at least one spouse is a full-year Wisconsin resident.

A married taxpayer who claims the federal earned income credit on a federal return using a head of household filing status may also claim the Wisconsin earned income credit on a Wisconsin return using a head of household filing status if the taxpayer has at least one qualifying child and is a full-year Wisconsin resident.

## K. Child Care Credit

### Federal Treatment

The child care credit is subject to an earned income limitation. A married taxpayer cannot claim more child care expenses than the earned income of the lower-earning spouse. Because this is based on "earned income," the limitation should be calculated ignoring income splitting. [I.R.C. § [21\(d\)](#).]

**Example:** Spouse A earns \$25,000 in wages. Spouse B earns \$4,000. They spend \$4,500 on work related child care expenses. They could not claim more than \$4,000 to figure the credit.

Generally married couples must file a joint return to take the credit. However, a married person may claim the credit on a separate return if he or she had custody of the child for more than half of the year, if he or she paid more than half of the cost of maintaining the home for the year and the other spouse did not live in the home for the last six months of the year.

However, in this situation, if the child care expenditures were paid with marital property, the spouse with custody of the child will only be able to claim half of the expenses. The other spouse will not be able to claim the other half because that spouse does not qualify for the credit.

### Wisconsin Treatment

Although Wisconsin does not have a child care credit, a married couple or married person who qualifies for the federal credit may qualify to claim a Wisconsin subtraction for child care expenses. The treatment of child care expenditures for purposes of the federal credit also applies for purposes of the Wisconsin subtraction.

**Caution:** Section 9631 of the American Rescue Plan Act of 2021 (P.L. 117-2) increased the amount of the child and dependent care expenses allowed for tax year 2021 to \$8,000 for one qualifying person and \$16,000 for two or more qualifying persons for purposes of the federal child and dependent care tax credit. This change does not apply for Wisconsin purposes. For purposes of the child and dependent care expense subtraction, qualifying expenses may not exceed \$3,000 if you have one qualifying person or \$6,000 if you have more than one qualifying person.

## 5. COLLECTION OF DELINQUENT TAXES

### A. Delinquent Taxes and the Marital Property Act

#### Federal Treatment

Generally, when a taxpayer fails to pay back taxes after receiving a notice that they are owed and a demand for payment from the IRS, a lien is created in favor of the IRS. This lien attaches to all of the delinquent taxpayer's property and rights to property. [IRC sec. [6321](#).] The IRS could collect any property subject to the lien to pay the

tax liability if it proceeds judicially. If the IRS proceeds administratively, certain exemptions are recognized by federal law.

The major impact of the Marital Property Act is to alter spouses' property rights. If a taxpayer's property rights are changed, the IRS' lien will be affected in the same way, because it attaches to the taxpayer's property and rights to property.

Also, the Marital Property Act classifies debts and gives creditors different collection remedies depending on the type of debt. These state remedies also may be used by the IRS in addition to the collection authority given under federal law.

The most important classification of debts under Wisconsin law is whether they "arose" before or after the "determination date." The "determination date" is the date that spouses and their property become subject to the Marital Property Act. [Sec. [766.01\(5\)](#), Wis. Stats.] This date is **after** all of the following have occurred:

- January 1, 1986
- The date the spouses were married
- The date that both spouses were "domiciled" in Wisconsin

As previously stated, the term "domicile" is a legal term that is similar to establishing permanent legal residency.

As will be discussed in the sections that follow, there are different federal tax collection consequences depending on whether the debt "arose" before or after the spouses became subject to the Marital Property Act. The date the debt "arises" would be the date that the act or omission that created the obligation occurred. Thus, an income tax liability "arises" at the end of the tax year. It would **not** arise when the IRS assesses the liability or demands payment.

### **Wisconsin Treatment**

Wisconsin income taxes not paid by the due date are delinquent, and the Department of Revenue will begin collection action. Any unpaid tax is a perfected lien in favor of the department upon all of the debtor's property and rights to property. The lien is effective at the time taxes are due or at the time an assessment is made, and it continues until the liability is satisfied. [Sec. [71.91\(4\)](#), Wis. Stats.]

Special presumptions apply to the collection of tax debts and other debts owed to the state. Generally, tax debts are classified based on when the debt was incurred. The type of debt determines what property the Department of Revenue can take to satisfy the debt.

All tax debts, including interest, penalties, and costs, incurred during marriage by a spouse after December 31, 1985, or after both spouses are domiciled in Wisconsin, whichever is later, are incurred in the interest of the marriage or the family. [Sec. [71.91\(3\)](#), Wis. Stats.] For Wisconsin income tax purposes, a tax debt, including interest, penalties, and costs, is incurred on the date of the department's initial assessment or notice of the amount due. [Sec. [71.91\(2\)](#), Wis. Stats.] This treatment applies for debts incurred for the 1986 tax year and later years.

As a result of these special presumptions which apply to the collection of delinquent Wisconsin taxes, the property of spouses available to satisfy delinquent federal and state tax debts may differ. These differences will be discussed in the sections that follow.

## B. Delinquent Taxes Arising Before the Determination Date

### Federal Treatment

As already discussed, the IRS has different collection rights depending on when the obligation was incurred. It is the position of the IRS that, with regard to delinquent taxes arising **before** the determination date (*i.e.*, **before** the marriage, January 1, 1986, **or** the date both spouses become domiciled in Wisconsin), the liability can be collected from any of the following sources:

- All of the property of the spouse who owes the taxes that is not marital property
- Any part of marital property that would have been property of the spouse but for the marriage or the enactment of marital property law
- The interest in marital property of the delinquent spouse (presumably half)

The creditor's rights to collect from the first two sources listed above are granted by the Marital Property Act. [Sec. [766.55\(2\)\(c\)1.](#) and [2.](#), Wis. Stats.] The right of the federal government to collect from half of marital property is a federal law consequence of the state law that gives each spouse a half interest in marital property.

The impact of the marital property law on tax debts that arose before the determination date is illustrated by the following example:

**Example:** Spouse A and Spouse B are married during 2014. Spouse A owes taxes that arose before marriage. Both Spouse A and Spouse B are employed and earn wages. Spouse A has real estate that was purchased during 2002. Spouse B owns stocks that were purchased during 2003. Under the Marital Property Act, the wages of both spouses are marital property; however, Spouse A's wages would have been Spouse A's property alone but for the marriage. The real estate is treated as if it were the individual property of Spouse A. The stocks are treated as if they were the individual property of Spouse B. Therefore, the IRS could collect the delinquent taxes from all of Spouse A's wages, half of Spouse B's wages, and all of Spouse A's real property. The stocks and half of Spouse B's wages, as the property of Spouse B, would not be available to the IRS.

Although the Marital Property Act does not allow collection of predetermination date debts from marital property [see sec. [766.55\(2\)\(c\)1.](#) and [2.](#), Wis. Stats.], these restrictions are not applicable to the collection of unpaid federal taxes. Since federal law gives the IRS a lien against all of the delinquent taxpayer's property and rights to property, the federal tax lien would attach to the delinquent taxpayer's half interest in marital property without regard to state law restrictions. [*Vorhies v. Z Management*, 87-1 U.S.T.C. 9200, 59 A.F.T.R.2d 87-658 (W.D. Wis. 1987); *Medaris v. United States*, 884 F.2d 832 (5th Cir. 1989); *In re Ackerman*, 424 F.2d 1148 (9th Cir. 1970); *In re Overman*, 424 F.2d 1142 (9th Cir. 1970); and *Brodway v. United States*, 455 F.2d 1097 (5th Cir. 1972).]

### Wisconsin Treatment

As previously indicated, for Wisconsin purposes a tax debt is incurred on the date of the department's initial assessment or notice of the amount due. [Sec. [71.91\(2\)](#), Wis. Stats.] However, this system of debt collection first applies to the 1986 tax year. Pre-1986 tax year debts are collected as predetermination date debts.

Predetermination date debts may be collected from the following sources:

- All nonmarital property of the spouse who incurred the debt
- That part of the marital property which would have been the debtor spouse's property if unmarried

The collection of Wisconsin income tax debts is illustrated by the following examples:

**Example 1:** Assume that the facts are the same as in the federal example on page 35. The department may collect the predetermination date tax debt from Spouse A's wages and Spouse A's real property. Spouse B's wages and Spouse B's stock are not available to the department to satisfy Spouse A's tax debt that arose before marriage.

**Example 2:** Assume the same facts as in Example 1, but the department issues an assessment to Spouse A in 2015 for the tax year 2013. Tax debts for the 1986 tax year and later tax years are incurred on the date of the department's assessment. Therefore, Spouse A's 2013 tax debt is considered to be incurred in the interest of the marriage and the family because it was assessed after the determination date and during marriage. In this case, the debt is collected as explained in Part C on page 37 under "Wisconsin Treatment."

### C. Delinquent Taxes Arising After the Determination Date

#### Federal Treatment

If the federal tax liability arose after the determination date (*i.e.*, **after** the date of marriage, January 1, 1986, **and** the date both spouses become domiciled in Wisconsin), the property that the IRS may use to satisfy delinquent taxes is different from that which may be used to satisfy a predetermination date debt.

The Marital Property Act classifies post-determination date debts as follows:

- Those that are incurred in the interest of the marriage and the family (family purpose obligations), and
- Those that are **not** incurred in the interest of the marriage and family (non-family purpose obligations).

[See sec. [766.55\(1\)](#), Wis. Stats.] The remedies available to the IRS are different for each type of debt.

There is a presumption under the Marital Property Act that debts arising after marriage and after the effective date of the Act are family purpose obligations. The law therefore assumes that the debt was incurred in the interest of the marriage or family, unless the taxpayer shows otherwise. [Sec. [766.55\(1\)](#), Wis. Stats.]

It is the position of the IRS that most taxes and penalties are family purpose obligations. In other community property jurisdictions, an obligation need not benefit the family directly to have a family purpose. All that is required is a relationship between the obligation and a business that benefits the community. [See, *e.g.*, *Garrett v. Shannon*, 13 Ariz. App. 332, 476 P.2d 538 (1970).] Since most taxes are incurred to generate income benefiting the family, they are family purpose obligations.

**Example:** Most income taxes are generated by wages, which are marital property, or by other income, which is used to support the marriage or family. Since there is a direct benefit to the marriage or family by the receipt of the income, the obligation for the taxes which attaches to the income is also family purpose. [See DeFuniak, *Principles of Community Property* at 241 (1943); *Wine v. Wine*, 14 Ariz. App. 103, 480 P.2d 1020 (1971); and sec. [71.91\(3\)](#), Wis. Stats. (state taxes are family purpose by statute).] Most employment tax liabilities are incurred by a spouse operating a sole proprietorship to support the family. Similarly, trust recovery penalties are incurred by a spouse working for wages to support the family. Accordingly, they should be family purpose. [*Hyde v. United States*, 93-2 U.S.T.C. ¶ 50,605, 72 A.F.T.R.2d ¶ 93-6150 (D. Ariz. 1993).] Therefore, the IRS believes that most taxes are family purpose obligations.

With regard to family purpose obligations arising after the determination date, these debts can be collected from any of the following sources:

- All of the property of the spouse who owes the taxes that is not marital property

- All marital property

[See sec. [766.55\(2\)\(b\)](#), Wis. Stats.]

With regard to non-family purpose obligations arising after marriage and after January 1, 1986, these debts can be collected from any of the following sources:

- All of the property of the spouse who owes the taxes that is not marital property
- 1/2 of marital property

[See sec. [766.55\(2\)\(d\)](#), Wis. Stats.]

This effect of the marital property law in these situations is illustrated by the following example:

**Example:** Spouse A and Spouse B were married during 2017. For 2018, Spouse A filed a separate income tax return reporting a tax liability but did not pay the tax due. Spouse A and Spouse B both are earning wages. Spouse A owns real estate purchased during 2016. Spouse B has stock purchased during 2016. The wages of both spouses are marital property. The real estate is the individual property of Spouse A, and the stock is the individual property of Spouse B. An income tax liability incurred after marriage is probably a family purpose obligation. Therefore, the IRS could collect the tax due from all of either spouse's wages, or the real estate. The stock would not be subject to the claim, because it is not marital property or the individual property of the spouse who owes the tax liability. If the tax liability was not a family purpose obligation, the IRS could only collect the debt from one-half of each spouse's wages and the real property.

### Wisconsin Treatment

As for federal purposes, the type of debt determines what property the department can take to satisfy it. Tax debts, including interest, penalties, and costs, for 1986 and later tax years incurred during marriage by a spouse after the determination date are incurred in the interest of the marriage or the family. Therefore, the following property is available for collection:

- All marital property
- All other property of the spouse who incurred the debt

[See secs. [71.91\(3\)](#), [766.55\(2\)\(b\)](#), and [859.18](#), Wis. Stats.]

If the department determines that one spouse is an "innocent spouse" and, therefore, is relieved from liability for the debt, the department may collect the debt from the following property:

- All nonmarital property of the spouse who incurred the debt
- The debtor spouse's interest in marital property, in that order

[See secs. [71.91\(3\)](#) and [766.55\(2\)\(d\)](#), Wis. Stats.]

Therefore, even though a spouse may be an "innocent spouse" under sec. [71.10\(6\)](#), Wis. Stats., a portion of the marital property income that their property or services produced may be used to satisfy a tax debt of the other spouse.

## D. Bankruptcy Marital Property Implications

### Federal Treatment

The impact of the Marital Property Act on bankruptcy is greatest in situations where only one spouse owes taxes, and that spouse files a separate bankruptcy petition without their spouse. Where this happens, **all** marital property, including the interest of the spouse who is not in bankruptcy, may be subject to the bankruptcy proceeding.

Under federal law, property that is part of the bankruptcy proceeding is referred to as being part of the "debtor's estate." The amount that creditors receive from the bankruptcy often depends on the value and amount of property that is included in the estate. If more property is included in the estate, it is more likely a creditor will be able to collect an unpaid debt.

Under sec. [766.55](#), Wis. Stats., debts incurred in the interest of the marriage or family may be satisfied from **all** marital property. All debts incurred by either spouse after the marriage are rebuttably presumed to be incurred in the interest of the marriage or family. Because a creditor could collect a debt from both spouses' halves of an item of marital property, that item would be included in the bankruptcy estate. This is so even though one spouse is not in bankruptcy.

Where a spouse who owes taxes files a separate petition in bankruptcy, the IRS, like any other creditor, attempts to collect as much tax as it is entitled to by law. In that case, the IRS will:

- Decide if the spouse who is not in bankruptcy has delinquent tax liabilities, and
- Decide if all assets that should be included in the bankruptcy estate have been disclosed.

Where only one spouse owes taxes and the other spouse files a separate bankruptcy petition, the IRS may file a claim in the bankruptcy relating to the liability of the spouse who is not in bankruptcy. This protects the IRS's claim to any marital property.

Also, where one spouse files a bankruptcy petition, only the petitioning spouse receives a discharge. However, a creditor cannot collect a debt, for which the petitioning spouse received a discharge, from post-petition property that the petitioning spouse has an interest (*i.e.*, the petitioning spouse's individual property and all the marital property). Since the petitioning spouse has an interest in all marital property, the nonpetitioning spouse receives a "hypothetical" discharge. Debts for which the petitioning spouse receives a discharge can be collected from the nonpetitioning spouse's individual property. If the marital community is terminated by death or divorce or the spouses move to a noncommunity property state, then the debts can be collected from all the property of the nonpetitioning spouse.

### Wisconsin Treatment

The Marital Property Act impacts various aspects of bankruptcy law in cases of married persons filing for relief under the bankruptcy code. A "claim against the debtor" includes a claim against the debtor or the debtor's property. [11 U.S.C. sec. [102\(2\)](#).] Additionally, the bankruptcy estate under 11 U.S.C. sec. [541\(a\)](#) includes nonmarital property of the spouse filing for bankruptcy, together with the marital property of both spouses, even if one spouse doesn't join in the bankruptcy petition. Since marital property of spouses can be reached in varying degrees by a creditor of either spouse in the case of a marital, premarital, or predetermination date debt, creditors pursuing debts incurred by the spouse who is not filing for bankruptcy will now participate in separate bankruptcy petitions filed by the other spouse.

When a spouse who doesn't owe delinquent taxes files a separate bankruptcy petition and the department has a marital, premarital, or predetermination date tax delinquency against the other spouse, the department may

file a proof of claim representing the taxes owed by the spouse who isn't filing for bankruptcy. If both the spouse who is filing for bankruptcy and the spouse who isn't joining in the bankruptcy petition have incurred tax liabilities, proof of claim will be filed covering both spouses' obligations. In the case of a joint bankruptcy petition, proof of claim will be filed for both spouses' obligations. Generally, the department handles bankruptcy matters on a case-by-case basis.

## E. Refund Offset Program

### Federal Treatment

Section [6402\(a\)](#) of the IRC gives the IRS authority to take current year tax refunds and apply them to unpaid taxes from prior years. Sections [6402\(c\)](#), [\(d\)](#), and [\(e\)](#) of the IRC give the IRS authority to offset refunds for debts owed other federal agencies, past due child support, and legally enforceable state income tax obligations. This procedure is referred to as "refund offset."

The enactment of the Marital Property Act affects the refund offset procedures largely in the area of so-called "injured spouse" claims. An injured spouse claim arises where spouses file a joint return claiming a refund. The IRS will offset the entire refund if either or both spouses are liable for past due child support, back taxes, or other federal obligations. If only one of the spouses is liable for the debt, the IRS will still offset the entire refund. This is done even though the other spouse may have a claim to part of the refund. The spouse who does not owe the obligation (the "injured spouse") could file a claim for their portion of the refund. These types of claims are called "injured spouse" claims.

Currently, the IRS has been encouraging spouses to file injured spouse claims with their original returns. Where a claim is received, the IRS would only offset the portion of the refund that belongs to the taxpayer who owes the debt. If no claim is filed, however, the IRS will still offset 100% of the refund.

Whether taxpayers live in community property states or common law states, the question that must be answered in processing an injured spouse claim is the same: What portion of the refund rightfully belongs to the injured spouse? In common law states, each spouse's tax liability is calculated separately based on their separate earnings or income.

Payments are also divided between the spouses and applied to their separate liabilities. This allows the IRS to decide the amount of each spouse's separate share of the refund. [See Rev. Rul. 80-7 and Rev. Rul. 80-8.] Since the Marital Property Act changes spouses' property rights, it also changes the formula for determining each spouse's interest in an income tax refund.

Under the Marital Property Act, the allocation would be based on distinguishing between marital and individual property. Marital property income is split equally between the spouses. Income that is not marital property will be allocated to the spouse who owns it. If it is not clear from the return whether the income is marital property, the income will be treated as marital property. The IRS will make this assumption because the Marital Property Act creates a rebuttable presumption that all property of spouses is marital property. [See sec. 766.31(1) and (2), Wis. Stats.] Withholding from wages and payments from a joint declaration of estimated tax will be treated as marital property and split equally between the spouses. Payments received from a separate declaration of estimated tax will be treated as the separate property of the spouse who made the declaration.

With respect to offsets involving child support, debts owed to other Federal agencies, or state income tax obligations, if an injured spouse claim is filed, the IRS will only offset the portion of the refund that represents the liable spouse's share of marital property or individual property. [*Oatman v. Secretary of the Treasury*, 34 F.3d 787 (9th Cir. 1994).] With respect to offsets for federal tax obligations, the IRS is entitled to any remedies that would be available to it to collect the tax under state or Federal law. These remedies may give the IRS a larger portion of the refund than it would be entitled to with respect to a nontax obligation. This will depend on

the characterization of the obligation (whether it was incurred before or after the determination date and whether it was family purpose) and the source of the refund.

If the federal tax obligation was incurred before the determination date, the IRS can retain the portion of the refund that is the liable spouse's individual property, the liable spouse's share of the refund that is marital property, and any portion of the refund that would have been the liable spouse's but for the marriage or the Marital Property Act. If the debt was incurred after the determination date, and it was family purpose, the IRS may offset all of the refund attributable to the liable spouse's individual property and all of the refund that is marital property. If the obligation was incurred after the determination date and is not family purpose, the IRS may offset all of the refund attributable to the spouse's individual property and half of the refund attributable to marital property. For a more complete discussion of these remedies and the legal basis for them, see Part 5., A. through C., on pages 33 to 37.

**Example:** Liable Spouse and Non-Liable Spouse file a joint return for Year 3, reporting an overpayment of \$100.00. After allocating the tax liability, \$75.00 of the overpayment is attributable to taxes withheld from Liable Spouse's wages, and \$25.00 of the overpayment is attributable to taxes withheld from Non-Liable Spouse's wages. If the liability was for past due child support, a debt to another federal agency, or state income tax obligation, the IRS could offset the portion of the refund attributable to Liable Spouse's individual property and the Liable Spouse's interest in the portion of the refund attributable to marital property. The wages are marital property and consequently the withholding credits from the wages are also marital property. [Treas. Reg. §1.31-1(a).] Therefore, the liable spouse's share of the marital property would be \$50, made up of \$37.50 from the Liable Spouse's withholding and \$12.50 of the Non-Liable spouse's withholding.

If the liability was for federal taxes incurred before the determination date, the IRS could offset the Liable Spouse's individual property, the Liable Spouse's share of marital property, and any portion of the refund that would have been the Liable Spouse's but for the marriage or the Marital Property Act. This amount would be \$87.50. This is made up of the Liable Spouse's share of the community property portion of the refund (\$37.50 from the Liable Spouse's withholding and \$12.50 of the Non-Liable spouse's withholding), plus the portion of the refund that would have been the Liable Spouse's but for the marriage or the Marital Property Act (the other half of the refund attributable to Liable Spouse's withholding or \$37.50). [Also see discussion in Rev. Rul. 2004-71, Situation 2.]

If the liability was for federal taxes incurred after the determination date and was a family purpose obligation, the IRS would be entitled to offset the portion of the refund that is the Liable Spouse's individual property and all of the refund that is marital property. This amount would be \$100, since the entire refund is marital property. [Also see discussion in Rev. Rul. 2004-71, Situation 4.]

If the liability was for post-determination date federal taxes not incurred in the interest of the marriage or family, the IRS would be entitled to offset all of the refund attributable to the spouse's individual property and half of the refund attributable to marital property. Since the entire refund is marital property the amount offset would be \$50, made up of \$37.50 from the Liable Spouse's withholding and \$12.50 of the Non-Liable Spouse's withholding. [Also see discussion in Rev. Rul. 2004-71, Situation 3.]

### Wisconsin Treatment

Chapter [71](#) of the Wisconsin Statutes contains special rules for the application of overpayments, refundable credits, or refunds claimed on joint, separate, or individual returns against amounts owed to the Department of Revenue, debts owed to other state agencies, municipalities or counties, or delinquent child or spousal support. As previously explained, for Wisconsin purposes, any tax debt is incurred on the date of the department's initial assessment or notice of the amount due. [Sec. [71.91\(2\)](#), Wis. Stats.] All tax debts incurred by a spouse during marriage after the determination date are incurred in the interest of the marriage or the family and may be



satisfied only from all marital property and all other property of the incurring spouse. [Secs. [71.91\(3\)](#), [766.55\(2\)\(b\)](#), and [859.18](#), Wis. Stats.]

However, if an "innocent spouse" exists (that is, a spouse is relieved of liability under sec. [71.10\(6\)\(a\)](#) or [\(b\)](#) or [\(6m\)\(a\)](#), Wis. Stats.), the obligation of the other spouse may be satisfied only from property of the debtor spouse that isn't marital property and from that spouse's interest in marital property, in that order. [See secs. [71.91\(3\)](#) and [766.55\(2\)\(d\)](#), Wis. Stats.; see also the set-off provisions under secs. [71.55\(1\)](#), [71.61\(1\)](#), and [71.80\(3\)](#) and [\(3m\)](#), Wis. Stats.]

Effective for a judgment of divorce entered on or after June 21, 1996, the department may not apply an overpayment, credit, or refund otherwise due an individual against any tax liability owed to the department by the individual or by the former spouse of the individual if (1) a judgment of divorce apportions that liability to the former spouse of the individual, and (2) if the individual provides the department with a copy of the judgment of divorce that apportions the tax liability. [Sec. [71.10\(6m\)\(b\)](#), Wis. Stats.]

A claim for refund on a separate return must be issued to the filer of that return, and a refund payable on a joint return must be issued jointly to the persons who filed that return. [Sec. [71.75\(8\)](#), Wis. Stats.] In addition, a marital property agreement or a unilateral statement cannot affect claims for refund. [Sec. [71.75\(6\)](#), Wis. Stats.]

**Note:** Effective for a judgment of divorce entered on or after October 29, 1999, if the judgment of divorce apportions any refund that may be due to one of the former spouses, or between the spouses, the department will issue the refund to the person to whom the refund is awarded under the terms of the judgment of divorce or the department will issue one check to each of the former spouses according to the apportionment terms of the judgment. A copy of that portion of the judgment of divorce that relates to the apportionment of the tax refund must be included with the income tax return. [Sec. [71.75\(8\)](#), Wis. Stats.]

#### (1) Joint Return

The department must give notice to spouses who have filed a joint return that it intends to reduce an overpayment, credit, or refund claimed by the amount of any liability. The amount will be credited against the liability unless, within 20 days of the notice date, the spouse who didn't incur the debt shows by clear and convincing evidence that the refund is their nonmarital property. If a spouse doesn't receive notice of the proposed offset and if the refund is incorrectly credited, a claim for refund of the incorrectly credited amount may be filed within two years after the date of the offset.

Notwithstanding sec. [766.55\(2\)\(d\)](#), Wis. Stats., the department may apply an overpayment from a joint return as follows:

- Against any liability from a joint return, unless an "innocent spouse" exists.
- Against any separate liability incurred during marriage by either spouse after the determination date, unless the spouse who doesn't owe the debt is an "innocent spouse."
- Against any amount owed the Department of Revenue that was incurred before January 1, 1986, or before marriage, whichever is later, to the extent that the refund is based on the Wisconsin adjusted gross income which would have been the property of the incurring spouse but for the marriage.
- Against any separate liability incurred by either spouse before the determination date to the extent that the refund is based on the Wisconsin adjusted gross income which would have been the property of the incurring spouse but for the marriage.

[Sec. [71.80\(3m\)](#), Wis. Stats.]

If an "innocent spouse" exists, the overpayment is prorated based on the ratio of the amount that would be the "guilty" or incurring spouse's income if not married to the total income of the spouses.

## (2) Separate or Individual Return

The Department of Revenue presumes that an overpayment, credit, or refund claimed on a separate or individual return is the nonmarital property of the filer. The department may credit such an overpayment against amounts owed the department, debts owed other state agencies, municipalities or counties, or delinquent child or spousal support owed by the filer. However, the spouse or former spouse of the filer may be able to claim a refund of amounts credited. The claim for refund must be made within two years after the overpayment was credited. The spouse who didn't incur the debt must be able to show by clear and convincing evidence that all or part of the overpayment was their nonmarital property.

Overpayments from separate or individual returns may be applied as follows:

- Against any separate liability incurred by the filer of the return
- Against any liability from a joint return, unless the filer is an "innocent spouse"

[Sec. [71.80\(3\)](#), Wis. Stats.]

## F. Offers in Compromise

### Federal Treatment

The IRS is permitted to compromise delinquent tax liabilities, based upon "doubt as to collectibility." [IRC sec. [7122](#).] In an offer in compromise, the IRS may accept less than the full amount of tax due, if the taxpayer can show that the amount he is offering is greater than the IRS would collect by selling the taxpayer's assets or from future income.

Based on the type of liability involved (pre- or post-determination date), and subject to the rules regarding collection sources discussed in the Delinquent Taxes sections of this publication, the IRS may consider all or part of existing marital property assets in evaluating the sufficiency of an offer in compromise. In evaluating the sufficiency of an offer in compromise, where appropriate, a revenue officer may consider the income of the spouse who does not owe the tax. In addition to offers based on doubt as to collectibility, there are also offers available based on doubt as to liability and to promote effective tax administration. The existence of marital property laws does not impact directly on these types of offers. See IRS [Form 656](#), *Offer in Compromise*, for more information on offers in compromise.

### Wisconsin Treatment

The Department of Revenue is also permitted to compromise delinquent tax liabilities in cases where the taxpayer is unable to pay the full amount. [Sec. [71.92](#), Wis. Stats.] The department may consider the income of the spouse who doesn't owe the tax. In addition, the Department of Revenue is permitted to compromise nondelinquent tax liabilities. See Wisconsin [Publication 124](#), *Petition for Compromise of Taxes – Inability to Pay*, for more information.

## 6. FEDERAL TAX BASIS

### Federal Treatment

Under the IRC, the tax basis of property acquired from a decedent is the property's fair market value on the date of the decedent's death. [IRC sec. [1014\(a\)](#).] If one-half of a decedent's interest in community property is includible in

a decedent's estate, the Code adjusts the basis of both halves of the property to fair market value. These concepts are important in Wisconsin because Wisconsin marital property would be considered community property for purposes of these IRC provisions.

The following example illustrates some of the rules regarding basis:

**Example:** Spouse A and Spouse B are married and reside in Wisconsin. Spouse A owns stock acquired before marriage for \$1,000 and held as individual property. Spouse A and Spouse B acquired real estate in Illinois for \$500, which was acquired before the determination date. They hold this property as joint tenants. Spouse A and Spouse B also own a home in Wisconsin. They acquired the home for \$2,000 and hold it as marital property. Spouse A dies leaving their half interest in the house and all of the stock to their son, Individual S. The Illinois property passes by operation of law to Spouse B. On the day Spouse A died, the stock was worth \$2,000, the Illinois property was worth \$1,500, and the house was worth \$10,000. Spouse A's stock, interest in the Illinois property, and interest in the house are all includible in Spouse A's federal gross estate. What are Individual S and Spouse B's tax bases in the described assets? Individual S's basis in the stock is \$2,000. Spouse A's basis in the half interest in the house is \$5,000. Spouse B's half interest in the Illinois property that she acquired from Spouse A is \$750. The basis of their own interest would not be adjusted and would remain at \$250. Spouse B's basis in their half interest in the house, however, is adjusted to \$5,000.

Under Wisconsin law, it is possible for property to be titled as individual property or in a common law estate (*e.g.*, joint tenancy or tenancy in common), but still be marital property. The IRS has ruled that this property qualifies for the double basis adjustment applied to community property. [Rev. Rul. 87-98.] Because of this, it is necessary to know when property is actually held as marital property.

The general rule is that property acquired by spouses after the determination date is rebuttably presumed to be marital property [Sec. [766.31\(1\)](#), [\(2\)](#) and [\(4\)](#), Wis. Stats.], but there are exceptions. [See sec. [766.31\(7\)](#), Wis. Stats.] For example, property received in exchange for individual property of a spouse is individual property. [Sec. [766.31\(7\)\(b\)](#), Wis. Stats.] Property received by gift or inheritance by one spouse but not the other is the individual property of that spouse. [Sec. [766.31\(7\)\(a\)](#), Wis. Stats.] Also, the appreciation in value of individual property of a spouse is individual property, unless it can be attributed to efforts of either spouse that were not reasonably compensated. [Secs. [766.31\(7\)\(c\)](#) and [766.63](#), Wis. Stats.]

Property acquired by a spouse before a marriage occurring after January 1, 1986, is their individual property. [Sec. [766.31\(6\)](#), Wis. Stats.] Property owned by a spouse before January 1, 1986, or before both spouses establish a Wisconsin domicile is not reclassified but is treated as individual property. [Sec. [766.31\(9\)](#), Wis. Stats.] This property would not be eligible for the double basis adjustment.

Property that is individual property can be reclassified in several different ways under the Act. The simplest way is by entering into a marital property agreement. [Sec. [766.31\(10\)](#), Wis. Stats.]

It may also be converted by mixing it with marital property. If the individual property component cannot be traced, it becomes marital property. [Sec. [766.63\(1\)](#), Wis. Stats.] Also, if either spouse provides substantial uncompensated efforts that cause appreciation to individual property, the appreciation in value is marital property. [Sec. [766.63\(2\)](#), Wis. Stats.] If all or part of individual property is converted to marital property and either spouse dies, the marital property portion qualifies for a double basis adjustment.

There are also specific statutory rules for property acquired in common law estates after the determination date. Property titled in tenancy in common or joint tenancy is marital property under the following conditions:

- Acquisition after the determination date in joint tenancy exclusively between spouses is survivorship marital property, unless the property was acquired by gift where the donor provided otherwise. [Sec. [766.60\(4\)\(b\)2](#), Wis. Stats.]

- Acquisition in tenancy in common **after** the determination date exclusively between the spouses is marital property, unless the property was acquired by gift where the donor provided otherwise. [Sec. [766.60\(4\)\(b\)2.](#), Wis. Stats.]

The Marital Property Act contains a provision allowing a surviving spouse to elect to have certain predetermination date property treated as marital property ("deferred marital property"). [Sec. [861.02](#), Wis. Stats.] Since this property was not marital property at the time of the death of the decedent spouse, it does not qualify for the double basis adjustment under IRC sec. [1014\(b\)\(6\)](#). [Cf., *Murphy v. Commissioner*, 342 F.2d 356 (9th Cir. 1965).] But, any property or interest in property included in the decedent's estate would still receive a basis adjustment to fair market value.

*Transfers to a spouse which are returned to the donor spouse after death of the donee within one year* - It is possible under a marital property agreement for a spouse owning nonmarital property to transmute that property into marital property by way of a marital property agreement. If the property becomes marital property, and the original "nontitled" spouse dies within one year, bequeathing the marital share back to the transferring spouse, it is the position of the IRS that IRC sec. [1014\(e\)](#) prohibits a double basis adjustment. This means that the donor spouse who reacquires the property receives the portion from decedent using that adjusted basis prior to death and receives no basis adjustment on the marital half owned by them.

*Joint tenancy and tenancy in common acquired before determination date* - Absent a marital property agreement or another occurrence reclassifying the property, this form of ownership will not be considered marital property and, therefore, only receives a basis adjustment on the portion includible in the estate.

*Marital property component* - Under sec. [766.63\(2\)](#), Wis. Stats., it is possible to have a marital property component arising from individual property where either spouse provides substantial efforts that caused appreciation. For this situation to create marital property, the spouse contributing services must not be reasonably compensated.

Under sec. [766.63\(1\)](#), Wis. Stats., it is also possible to convert individual property to marital property by mixing it with marital property. This creates a marital property component, if the marital property can be traced. Otherwise, the mixing converts the individual property to marital property. To the extent that individual property is converted to marital property under these rules, it will receive a double basis adjustment.

**Example:** If one spouse owns nonmarital property worth \$50,000 that was increased in value to \$100,000 solely through the efforts of either spouse, that \$50,000 appreciation in value would be a marital property component which would receive the benefits of IRC sec. [1014\(b\)\(6\)](#).

## Wisconsin Treatment

The Wisconsin basis of property acquired from a decedent is determined under sec. [1014](#) of the IRC. However, for deaths occurring before January 1, 1992, a modification may be necessary to recognize any difference between the federal estate tax and Wisconsin inheritance tax values. [Sec. [71.05\(10\)\(e\)](#), Wis. Stats.] **Caution:** A basis adjustment may be down as well as up.

For Wisconsin income tax purposes, the exchange of former marital property interests between a surviving spouse and a distributee of the decedent spouse is a nontaxable exchange. Any gain or loss recognized on such an exchange for federal income tax purposes is treated as a subtraction from or an addition to federal adjusted gross income, as appropriate, on the Wisconsin income tax return. [Sec. [71.05\(6\)\(a\)16.](#) and [\(b\)12.](#), Wis. Stats.] The exchange is treated for basis purposes as if each asset received in the exchange were acquired by gift from the other party. [Sec. [71.05\(12\)\(d\)](#), Wis. Stats.]

## 7. S CORPORATIONS

### S Corporation Elections

## Federal Treatment

Under current law, all persons who are shareholders of a corporation must consent to a subchapter S election for the election to be valid. [IRC sec. [1362\(a\)\(2\)](#).] The consents are filed with the IRS. Where shares of stock are held as community property, both spouses are treated as shareholders, and the consent of both spouses is required. [Treas. Reg. 1.1362-6(b)(2).] If the consent of both spouses is not obtained, the election is invalid. [*Clemens v. Commissioner*, T.C. Memo 1969-235, *aff'd per curiam*, 453 F.2d 869 (9th Cir. 1971).] Because marital property is a form of community property, these rules also apply to subchapter S corporation stock held as marital property.

Taxpayers can obtain automatic relief for making late consents to S corporation elections in community property states as long as the initial election was invalid merely because [Form 2553](#), *Election by a Small Business Corporation*, did not contain the signature of a spouse who was a shareholder due to state community property laws, and both spouses have reported all items of income consistent with the S Corporation election on all affected federal returns. [Rev. Proc. 2004-35.]

## Wisconsin Treatment

For Wisconsin purposes, a tax-option (S) corporation is defined as a corporation which is treated as an S corporation under Subchapter S of the IRC and has not elected out of tax-option corporation status under sec. [71.365\(4\)\(a\)](#), Wis. Stats. If a federal S election isn't valid because both spouses didn't consent, then the election won't be valid for Wisconsin purposes either.

## 8. ADDITIONAL INFORMATION

If, after reading this publication, you have further questions about the federal or Wisconsin treatment of items under Wisconsin's Marital Property Act, please contact the following:

### Federal Questions

Telephone: 1-800-829-1040

### Wisconsin Questions

Mail Stop 6-40

Wisconsin Department of Revenue

Technical Services Staff

P.O. Box 8933

Madison, WI 53708-8933

Telephone: (608) 266-2772

Email: [DORISERechnicalServices@wisconsin.gov](mailto:DORISERechnicalServices@wisconsin.gov)

### Applicable Laws and Rules

This document provides statements or interpretations of the following laws and regulations in effect as of January 25, 2022: chs. 71, 766, 859, and 861, Wis. Stats., titles 11, 26, and 42 of the IRC, and title 26 of the Code of Federal Regulations

Laws enacted and in effect after this date, new administrative rules, and court decisions may change the interpretations in this document. Guidance issued prior to this date, that is contrary to the information in this document is superseded by this document, according to sec. 73.16(2)(a), Wis. Stats.