Filing Status

The filing status you use when you file your return determines the tax rates that will apply *(1.2)* to your taxable income. Filing status also determines the standard deduction you may claim *(13.1)* if you do not itemize deductions and your ability to claim certain other deductions, credits, and exclusions.

This chapter explains the five different filing statuses: single, married filing jointly, married filing separately, head of household, and qualifying widow(er). If you are married, filing a joint return is generally advantageous, but there are exceptions discussed in *1.3*. If you are unmarried and are supporting a child who lives with you, you may qualify as a head of household *(1.12)*, which will enable you to use more favorable tax rates than those allowed for single taxpayers. If you were widowed in either 2008 or 2007 and in 2009 a dependent child lived with you, you may be able to file as a qualifying widow(er) for 2009, which allows you to use joint return rates *(1.11)*.

Special filing situations, such as for children, nonresident aliens, and deceased individuals, are also discussed in this chapter.

Your personal or family status also determines the number of personal exemptions you may claim on your return. For 2009, each personal exemption you claim is the equivalent of a $3,650 deduction *(21.1)*.

Importance of Filing Status

1.1 Which Filing Status Should You Use?

Your filing status generally depends on whether you are married at the end of the year, and, if unmarried, whether you maintain a household for a qualifying dependent. The five filing statuses are: single, married filing jointly, married filing separately, head of household, and qualifying widow or widower.

If you are *married at the end of the year,* you may file jointly *(1.4)* or separately *(1.3)*. If you lived apart from your spouse for the last half of 2009 and your child lived with you, you may qualify as an "unmarried" head of household *(1.12)*, which allows you to apply more favorable tax rates than you could as a married person filing separately.

If you are *unmarried at the end of the year,* your filing status is single unless you meet the tests for a head of household or qualifying widow(er). Generally, you are a head of household *(1.12)* if you pay more than 50% of the household costs for a dependent child or relative who lives with you, or a dependent parent, whether or not he or she lives with you. You generally are a qualifying widow(er) *(1.11)* if you were widowed in 2007 or 2008 and in 2009 you pay more than 50% of the household costs for you and your dependent child. The tax rates for heads of household and for qualifying widow(er)s are more favorable than those for single taxpayers *(1.2)*.

The filing status you use determines the tax rates that apply to your taxable income *(1.2)*, as well as the standard deduction you may claim *(13.1)* if you do not itemize deductions. Certain other deductions, credits, or exclusions are also affected by filing status. For example, if you are married, certain tax benefits are only allowed if you file jointly, but more deductions overall may be allowed in certain cases if you file separately *(1.3)*. The deduction for personal exemptions is phased out *(21.12)* for high income taxpayers at levels based upon filing status.

Planning Reminder

Getting Married Can Raise Your Taxes

The so-called marriage penalty is faced by couples whose joint return tax liability exceeds the combined tax they would pay if single. This is generally the case where each spouse earns a substantial share of the total income. On the other hand, if one spouse has little or no income, there generally is a marriage bonus or singles penalty, as the couple's tax on a joint return is less than the sum of the tax liabilities that would be owed if they were single.

Tax legislation has reduced the marriage penalty by increasing the standard deduction *(13.1)* for married couples filing jointly to double the amount allowed to a single person, and also making the 15% bracket *(1.2)* twice as wide.

Marital status determined at the end of the year. For federal tax purposes, a marriage means only a legal union between a man and a woman as husband and wife.

If you are divorced during the year under a final decree of divorce or separate maintenance, you are treated as unmarried for that whole year, assuming you have not remarried before the end of the year. For the year of the divorce, file as a single person unless you care for a child or parent and qualify as a head of household *(1.12)*.

If at the end of the year you are living apart from your spouse, or you are separated under a provisional decree that has not yet been finalized, you are not considered divorced. If you care for a child and meet the other head of household tests *(1.12)*, you may file as an unmarried head of household. Otherwise, you must file a joint return or as a married person filing separately.

If at the end of the year you live together in a common law marriage that is recognized by the law of the state in which you live or the state where the marriage began, you are treated as married.

If your spouse dies during the year, you are treated as married for that entire year and may file a joint return for you and your deceased spouse, assuming you have not remarried before year's end *(1.10)*.

1.2 Tax Rates Based on Filing Status

The most favorable tax brackets apply to married persons filing jointly and qualifying widow(er)s *(1.11)*, who also use the joint return rates. The least favorable brackets are those for married persons filing separately, but filing separately is still advisable for married couples in certain situations *(1.3)*. *See Table 1-1* for a comparison of the 2009 tax rate brackets.

If you have children and are unmarried at the end of the year, do not assume that your filing status is single. If your child lives with you in a home you maintain, you generally may file as a head of household *(1.12)*, which allows you to use more favorable tax rates than a single person. If you were widowed in either of the two prior years and maintain a household for your dependent child, you generally may file as a qualified widow(er), which allows you to use favorable joint return rates *(1.11)*.

If you are married at the end of the year but for the second half of the year you lived with your child apart from your spouse, and you and your spouse agree not to file jointly, you may use head of household tax rates, which are more favorable than those for married persons filing separately.

What is your top tax bracket and effective tax rate? Your top marginal tax rate for 2009 is 10%, 15%, 25%, 28%, 33%, or 35%, depending on your taxable income *(22.1)*. The rate brackets for 2009 are shown in *Table 1-1*. If your top bracket is 25%, for example, this means that each additional dollar of *ordinary* income (such as salary or interest income) will be taxed at 25% for regular income tax purposes. However, because the rate brackets are graduated, your effective tax rate may be significantly lower than your top (marginal) rate. For example, if in 2009 you are single with taxable income of $35,100, all of which is ordinary income, your marginal rate is 25%, but the first $8,350 is taxed at 10%, the next $25,600 ($33,950 – $8,350) is taxed at 15%, and only the last $1,150 ($35,100 – $33,950) is taxed at 25%. The total tax is $4,963, which represents an "effective rate" of 14.14% ($4,963/$35,100 taxable income), reflecting the fact that most of your taxable income is taxed in the 10% and (especially) the 15% brackets.

The tax rate on qualified dividends *(4.2)* and net capital gains *(5.3)* is generally lower than your top bracket rate on ordinary income. Qualified dividends and net capital gains are generally subject to a maximum 15% tax rate, but for taxpayers whose top rate bracket for 2009 *(Table 1-1)* is 10% or 15%, there is no tax; the rate on qualified dividends and net capital gains is zero (0%). For 28% rate gains or unrecaptured Section 1250 gains *(5.3)*, the zero and 15% rates do not apply, but the rate cannot exceed 25% for unrecaptured Section 1250 gains or 28% for 28% rate gains.

To actually compute your 2009 regular income tax, you will either look up your tax in the Tax Table, use the Tax Computation Worksheet, or, if you have net capital gains or qualified dividends, use the Qualified Dividends and Capital Gain Tax Worksheet or Schedule D Tax Worksheet. *Chapter 22* explains these alternatives.

AMT. If you are subject to alternative minimum tax (AMT) on Form 6251, you generally apply either a 26% or 28% rate to your AMT taxable income (as reduced by the applicable AMT exemption), but the favorable regular tax rates for net capital gains and qualified dividends also apply for AMT purposes *(23.1)*.

Table 1-1 Taxable Income Brackets for 2009

	10% bracket applies to taxable income up to—	*15% bracket applies to taxable income up to—*	*25% bracket applies to taxable income up to—*	*28% bracket applies to taxable income up to—*	*33% bracket applies to taxable income up to—*	*35% bracket applies to taxable income over—*
Married filing separately	$ 8,350	$ 33,950	$ 68,525	$ 104,425	$ 186,475	$ 186,475
Single	8,350	33,950	82,250	171,550	372,950	372,950
Head of household	11,950	45,500	117,450	190,200	372,950	372,950
Married filing jointly or Qualifying widow(er)	16,700	67,900	137,050	208,850	372,950	372,950

Married Taxpayers

1.3 Filing Separately Instead of Jointly

Filing a joint return saves taxes for a married couple where one spouse earns all, or substantially all, of the taxable income. If both you and your spouse earn taxable income, you should figure your tax on joint and separate returns to determine which method provides the lower tax.

Although your tax rate *(1.2)* will generally be higher on a separate return, filing separately may provide an overall tax savings (for both of you together) where filing separately allows you to claim more deductions. On separate returns, larger amounts of medical expenses, casualty losses, or miscellaneous deductions may be deductible because lower adjusted gross income floors apply. Unless one spouse earns substantially more than the other, separate and joint tax rates are likely to be the same, regardless of the type of returns filed. The Example on page 12 illustrates how filing separately can save you taxes.

Suspicious of your spouse's tax reporting? If you suspect that your spouse is evading taxes and may be liable on a joint return, you may want to file a separate return. By filing separately, you avoid liability for unpaid taxes due on a joint return, plus interest and penalties.

Planning Reminder

Switching From Separate to Joint Return

If you and your spouse file separate returns, you have three years from the due date (without extensions) to change to a joint return. If a joint return is filed, you may not change to separate returns once the due date has passed. The filing of separate or joint estimated tax installments *(27.4)* does not commit you to a similar tax return.

Filing Tip

Can Filing Separately Avoid Exemption Phaseout or Itemized Deduction Reduction?

Filing separately will sometimes allow either you or your spouse to avoid part of the personal exemption phaseout *(21.12)* or the reduction to specified itemized deductions *(13.7)*. If you file jointly and have total 2009 adjusted gross income (AGI) exceeding $250,200, the exemption phaseout applies. If you file separately, the phaseout does not apply to the spouse reporting separate AGI of $125,100 or less. On the other hand, where your joint AGI is $250,200 or less, a spouse reporting AGI over $125,100 on a separate return will be subject to the phaseout although no phaseout would apply on a joint return.

If for 2009 you itemize deductions, the deductions for taxes, mortgage interest, charitable donations, and miscellaneous deductions are reduced if AGI exceeds $166,800 on a joint return, or exceeds $83,400 on a separate return. If you file separately, the reduction does not apply on a separate return showing AGI of $83,400 or less. Where joint AGI is $166,800 or less, a spouse filing separately with separate AGI over $83,400 is subject to the reduction although no reduction would apply on a joint return.

If you do file jointly and the IRS tries to collect tax due on the joint return from you personally, you may be able to avoid liability under the innocent spouse rules *(1.7)*. If you are no longer married to or are separated from the person with whom you jointly filed, you may be able to elect separate liability treatment *(1.8)*.

Standard deduction restriction on separate returns. Keep in mind that if you and your spouse file separately, both must either itemize or claim the standard deduction, which is $5,700 in 2009 for married persons filing separately *(13.3)*. Thus, if your spouse itemizes deductions on Schedule A of Form 1040, your standard deduction is zero; you do not have the option of claiming the $5,700 standard deduction and must itemize your deductions even if they are much less than $5,700.

EXAMPLE

Mike Palmer's 2009 adjusted gross income (AGI) is $84,775, and Fran, his wife, has AGI of $60,000. Neither of them has dependents. Mike has unreimbursed medical expenses of $7,984 *(17.2)* before taking into account the 7.5% of AGI floor *(17.1)*; Fran's unreimbursed expenses are $1,000. A tornado damaged property owned by Mike in his own name, and he has a casualty loss of $20,078 prior to taking into account the $500 floor and the 10% of AGI floor *(18.13)*. Mike has unreimbursed miscellaneous expenses of $2,996 and Fran has $500 prior to taking into account the 2% of AGI floor *(19.1)*. Mike has deductible mortgage interest expenses of $5,000 and Fran has $2,000. Mike's deductible state and local taxes are $2,499; Fran's are $1,000. If they file separately and Mike itemizes deductions, Fran must also itemize even though the standard deduction would give her a larger deduction *(13.3)*.

As the example worksheet below shows, filing separate returns saves Mike and Fran an overall $2,069, because they can deduct more on separate returns. If they filed jointly, their deductible casualty loss would be substantially lower and they would receive no deduction for medical expenses because it would be eliminated by the adjusted gross income floor. If they file separately, the reduction of itemized deductions *(13.7)* applies to Mike but not Fran because only Mike's AGI exceeds the $83,400 threshold. If they file jointly, the reduction does not apply because their AGI is below the $166,800 threshold for joint returns. The phaseout of personal exemptions *(21.12)* does not apply regardless of how they file.

Item		*Mike (Separately)*	*Fran (Separately)*	*Joint Return*
1.	**AGI**	**$ 84,775**	**$ 60,000**	**$ 144,775**
2.	Medical expenses	7,984	1,000	8,984
	Less 7½% of AGI	6,358	4,500	10,858
	Allowable medical	1,626	0	0
3.	Taxes	2,499	1,000	3,499
4.	Mortgage interest	5,000	2,000	7,000
5.	Casualty loss	20,078	0	20,078
	Less $500 and 10% of AGI *(18.12)*	8,978		14,978
	Allowable casualty	11,100		5,100
6.	Miscellaneous expenses	2,996	500	3,496
	Less 2% of AGI	1,696	1,200	2,896
	Allowable miscellaneous	1,300	0	600
7.	**Total itemized** ***(Lines 2–6)***	**21,525**	**3,000**	**16,199**
	Less reduction *(13.7)*	48	0	0
8.	**Net itemized**	**21,477**	**3,000**	**16,199**
9.	Personal exemptions	3,650	3,650	7,300
10.	**Net itemized plus exemptions**	**25,127**	**6,650**	**23,499**
11.	**Taxable income** *(Line 1 minus Line 10)*	59,648	53,350	121,276
12.	***Tax liability***	**11,094**	**9,531**	**22,694**
	Total tax filing separately			20,625
	Savings from filing separately			***2,069***

Joint return required for certain benefits. Also be aware that certain tax benefits may be claimed by married persons only if they file jointly.

If you want to take advantage of the $25,000 rental loss allowance *(10.2)* or the credit for the elderly and disabled *(Chapter 34)*, you must file jointly unless you live apart for the whole year. You must file jointly to claim an IRA deduction for a nonworking spouse *(8.3)*. Roth IRA contributions generally may not be made by a married person filing separately because of an extremely low phase-out range *(8.20)*. You must file jointly to convert a traditional IRA to a Roth IRA *(8.21)*. A joint return is required to claim the Hope credit or lifetime learning credit *(33.7)*, the tuition and fees deduction *(33.13)*, or the deduction for student loan interest *(33.14)*. You must file jointly to claim the dependent care credit or the earned income credit *(Chapter 25)*, unless you live apart for the last six months of the year.

Other restrictions may increase your tax if you file a separate return. In figuring whether you are subject to alternative minimum tax (AMT), your exemption amount is half that allowed to a joint return filer *(23.1)*. Furthermore, if you receive Social Security benefits, 85% of your benefits are generally subject to tax on a separate return; *see Chapter 34*.

1.4 Filing a Joint Return

If you are married at the end of the year, you may file a joint return with your spouse. For federal tax purposes, a marriage means only a legal union between a man and woman as husband and wife. Filing jointly saves taxes for many married couples, but if you and your spouse both earn taxable income, in some cases overall tax liability is reduced by filing separately *(1.3)*.

You may not file a 2009 joint return if you were divorced under a decree of divorce or separate maintenance that is *final* by the end of the year. You may file jointly if you separated during 2009 under an interlocutory (temporary or provisional) decree or order, so long as a final divorce decree was not entered by the end of the year. If during the period that a divorce decree is interlocutory you are permitted to remarry in another state, the IRS recognizes the new marriage and allows a joint return to be filed with the new spouse. However, courts have refused to allow a joint return where a new marriage took place in Mexico during the interlocutory period in violation of California law.

Both spouses generally liable on joint return but "innocent" spouse may be relieved of liability. When you and your spouse file jointly, each of you may generally be held individually liable for the entire tax due, plus interest and any penalties. The IRS may try to collect the entire amount due from you even if your spouse earned all of the income reported on the joint return, or even if you have divorced under an agreement that holds your former spouse responsible for the taxes on the joint returns you filed together. However, there are exceptions to this joint liability rule for "innocent" spouses and for divorced or separated persons.

You may be able to obtain *innocent spouse* relief where tax on your joint return was understated without your knowledge because your spouse omitted income or claimed erroneous deductions or tax credits. In such a case, you may make an innocent spouse election within two years from the time the IRS begins a collection effort from you for taxes due on the return *(1.7)*.

Furthermore, if you are divorced, legally separated, living apart or the spouse with whom you filed jointly has died, you may be able to avoid tax on the portion of a joint return deficiency that is allocable to your ex-spouse by making a separate liability election *(1.8)* within two years of the time the IRS begins collection efforts against you. You may make the separate liability election even if you apply for innocent spouse relief. In some cases, it may be easier to qualify for relief under the separate liability rules than under the innocent spouse rules because innocent spouse relief may be denied if you had "reason to know" that tax was understated on the joint return, whereas the IRS must show that you had "actual knowledge" of the omitted income or erroneous deductions or credits to deny a separate liability election.

Signing the joint return. Both you and your spouse must sign the joint return. Under the following rules, if your spouse is unable to sign, you may sign for him or her.

If, because of illness, your spouse is physically unable to sign the joint return, you may, with the oral consent of your spouse, sign his or her name on the return followed by the words "By ______, Husband (or Wife)." You then sign the return again in your own right and attach a signed and dated statement with the following information: (1) the type of form being filed, (2) the tax year, (3) the reason for the inability of the sick spouse to sign, and (4) that the sick spouse has consented to your signing.

Filing Tip

Spouse in Combat Zone

If your spouse is in a combat zone or a qualified hazardous duty area *(35.4)*, you can sign a joint return for your spouse. Attach a signed explanation to the return.

To sign for your spouse in other situations, you need authorization in the form of a power of attorney, which must be attached to the return. IRS Form 2848 may be used.

If your spouse does not file, you may be able to prove you filed a joint return even if your spouse did not sign and you did not sign as your spouse's agent where:

- You intended it to be a joint return—your spouse's income was included (or the spouse had no income).
- Your spouse agreed to have you handle tax matters and you filed a joint return.
- Your answers to the questions on the tax return indicate you intended to file a joint return.
- Your spouse's failure to sign can be explained.

EXAMPLE

The Hills generally filed joint returns. In one year, Mr. Hill claimed joint return filing status and reported his wife's income as well as his own; in place of her signature on the return, he indicated that she was out of town caring for her sick mother. She did not file a separate return. The IRS refused to treat the return as joint. The Tax Court disagreed. Since Mrs. Hill testified that she would have signed had she been available, her failure to do so does not bar joint return status. The couple intended to make a joint return at the time of filing.

1.5 Nonresident Alien Spouse

If either you or your spouse was a nonresident alien *(1.16)* during any part of the year, a joint return may be filed only if both of you make a special election to be taxed on your worldwide income. Thus, if you are a U.S. citizen and your spouse is a nonresident alien at the beginning of the year who becomes a resident during the year, the special election to file jointly must be made.

If the election is not made, you may be able to claim your nonresident alien spouse as an exemption on a return filed as married filing separately, but only if the spouse had no income and could not be claimed as a dependent by another taxpayer *(21.2)*. If the alien spouse becomes a resident before the beginning of the next tax year, you may file jointly for that year.

A couple who make the election must keep books and records of their worldwide income and give the IRS access to such books and records. If either spouse does not provide the necessary information to the IRS, the election is terminated. Furthermore, the election is terminated if either spouse revokes it or dies; revocation before the due date of the return is effective for that return. The election automatically terminates in the year following the year of the death of either spouse. However, if the survivor is a U.S. citizen or resident and has a qualifying child, he or she may be able to use joint return rates as a qualifying widow or widower *(1.11)* in the two years following the year of the spouse's death. The election to file jointly also terminates if the couple is legally separated under a decree of divorce or separate maintenance. Termination is effective as of the beginning of the taxable year of the legal separation. If neither spouse is a citizen or resident for any part of the taxable year, an election may not be made and an existing election is suspended. If an election is suspended it may again become effective if either spouse becomes a U.S. citizen or resident. Once the election is terminated, neither spouse may ever again make the election to file jointly.

Electing to file a joint return does not terminate the special withholding on the nonresident alien's income.

Filing Tip

Election To File a Joint Return

Where a U.S. citizen or resident is married to a nonresident alien, the couple may file a joint return if both elect to be taxed on their worldwide income. The requirement that one spouse be a U.S. citizen or resident need be met only at the close of the year. Joint returns may be filed in the year of the election and all later years until the election is terminated.

Filing Tip

Nonresident Alien Becomes Resident

Where one spouse is a U.S. citizen or resident and the other is a nonresident alien who becomes a resident during the tax year, the couple may make a special election to file a joint return for that year and be taxed on their worldwide income. Thereafter, neither spouse may make the election again even if married to a new spouse. *See* the tests for determining status as a resident or nonresident alien *(1.18)*.

1.6 Community Property Rules

If you live in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, or Wisconsin, the income and property you and your spouse acquire during the marriage is generally regarded as community property. Community property means that each of you owns half of the community income and community property, even if legal title is held by only one spouse. But note that there are some instances in which community property rules are disregarded for tax purposes; these instances are clearly highlighted in the pertinent sections of this book.

Separate property may still be owned. Property owned before marriage generally remains separate property; it does not become community property when you marry. Property received during the marriage by one spouse as a gift or an inheritance from a third party is generally separate property. In some states, if the nature of ownership cannot be fixed, the property is presumed to be community property.

In some states, income from separate property may be treated as community property income. In other states, income from separate property remains the separate property of the individual owner.

Divorce or separation. If you and your spouse divorce, your community property automatically becomes separate property. A separation agreement or a decree of legal separation or of separate maintenance may or may not end the marital community, depending on state law.

Community income rules may not apply to separated couples. If a husband and wife in a community property state file separate returns, each spouse must generally report one-half of the community income. However, a spouse may be able to avoid reporting income earned by his or her spouse if they live apart during the entire calendar year and do not file a joint return.

To qualify, one or both spouses must have earned income for the year and none of that earned income may be transferred, directly or indirectly, between the spouses during the year. One spouse's payment to the other spouse solely to support the couple's dependent children is not a disqualifying transfer. If the separated couple qualifies under these tests, community income is allocated as follows:

- Earned income (excluding business or partnership income) is taxed to the spouse who performed the personal services.
- Business income (other than partnership income) is treated as the income of the spouse carrying on the business.
- Partnership income is taxed to the spouse entitled to a distributive share of partnership profits.

Innocent spouse rules apply to community property. As discussed above, community property rules may not apply to earned income where spouses live apart for the entire year and file separate returns. In addition, a spouse who files a separate return may be relieved of tax liability on community income that is attributable to the other spouse if he or she does not know (or have reason to know) about the income and if it would be inequitable under the circumstances for him or her to be taxed on such income. Even if you fail to qualify for such relief because you knew (or had reason to know) about the income, the IRS may relieve you of liability if it would be inequitable to hold you liable.

The IRS may disregard community property rules and tax income to a spouse who treats such income as if it were solely his or hers and who fails to notify the other spouse of the income before the due date of the return (including extensions).

Relief from liability on joint return. If you file jointly, you may elect to avoid liability under the innocent spouse rules *(1.7)* and the separate liability rules *(1.8)*. In applying those rules, items that would otherwise be allocable solely to your spouse will not be partly allocated to you merely because of the community property laws.

Death of spouse. The death of a spouse dissolves the community property relationship, but income earned and accrued from community property before death is community income.

Moving from a community property to a common law (separate property) state. Most common law states (those which do not have community property laws) recognize that both spouses have an interest in property accumulated while residing in a community property state. If the property is not sold or reinvested, it may continue to be treated as community property. If you and your spouse sell community property after moving to a common law state and reinvest the proceeds, the reinvested proceeds are generally separate property, which you may hold as joint tenants or in another form of ownership recognized by common law states.

Moving from a common law to a community property state. Separate property brought into a community property state generally retains its character as separately owned property. However, property acquired by a couple after moving to a community property state is generally owned as community property. In at least one state (California), personal property that qualifies as community property is treated as such, even though it was acquired when the couple lived in a common law state.

Supporting a dependent with separate rather than community income. Filing a Form 2120 multiple support agreement is not necessary where either parent can prove that he or she has income that is considered separate income rather than community income; that parent may be able to satisfy the more-than-50% support test. In certain community property states, the law may provide that income of a husband and wife living apart is considered separate income rather than community income.

IRS Alert

Income Splitting Barred to California Registered Domestic Partner

In a 2006 legal memorandum, the IRS concluded that the community property income-splitting rule allowed to California spouses does not apply to registered domestic partners, despite the California law (effective in 2005) that extended to registered domestic partners community property rights and virtually all other spousal rights and responsibilities. Thus, a California registered domestic partner must report all of his or her earned income from personal services. He or she cannot report on a separate federal return only one-half of the combined income of both partners, as he or she could if married. According to the IRS, domestic partners under the California law are not married and Supreme Court precedent allowing married couples in community property states to split income applies only to husbands and wives.

Avoiding or Limiting Liability on Joint Returns

Caution

Knowledge May Bar Innocent Spouse Relief

The IRS may try to defeat your claim for innocent spouse relief on the grounds that you knew, or should have known, that tax was understated on the joint return.

Law Alert

IRS Must Notify Non-Electing Spouse

After the filing of Form 8857, the IRS is required to notify the non-electing spouse (or former spouse) of an electing spouse's request for relief and allow the non-electing spouse an opportunity to participate in the determination. If the IRS makes a preliminary determination granting full or partial relief to the electing spouse, the non-electing spouse may file a written protest and obtain an Appeals Office conference.

1.7 Innocent Spouse Rules

Unless you qualify for relief, you are personally liable for any tax due on a joint return you have filed, whether you are still married to the spouse with whom you filed the joint return or you have since divorced or separated.

If you are still married and living with the same spouse, the only way to avoid personal liability on the joint return is to qualify as an innocent spouse under the rules in this section, or to apply for equitable relief from the IRS *(1.9)*.

If you are divorced, legally separated, living apart, or your spouse has died, you may either seek relief under the innocent spouse rules below or you may be able to elect separate liability treatment *(1.8)* or seek equitable relief *(1.9)* from the IRS.

Qualifying tests for innocent spouse election. You must satisfy all of the following conditions to qualify for innocent spouse relief:

1. The tax shown on the joint return was understated due to the omission of income by your spouse, or erroneous deductions or credits claimed by your spouse.
2. When signing the joint return, you did not know and had no reason to know that tax on the return was understated.

   According to the IRS and Tax Court, where your claim for innocent spouse relief is based on the omission of income by your spouse, knowledge of the underlying transaction that produced the omitted income (such as a retirement distribution received by your spouse or an investment held by your spouse in his own name) is enough to bar your claim, even if you did not know that the amount of taxable income reported on the joint return was incorrect. The Courts of Appeal for both the Fifth Circuit and the District of Columbia Circuit agree with the Tax Court that knowledge of the underlying transaction that produced the omitted income defeats a claim for innocent spouse relief.

   The Tax Court may also hold that knowledge of the underlying transaction bars innocent spouse relief where the request for relief is based on improper deductions or tax credits attributed to the other spouse. However, in erroneous deduction (or credit) cases arising under prior law, most appeals courts held that relief should be denied under the knowledge test only if, given all the facts and circumstances, the spouse seeking relief knew or had reason to know that the deduction would result in a tax understatement, and this depends on his or her education level and involvement in the couple's financial affairs.

   Although the "knowledge" test continues to be a significant hurdle, partial relief may be available. If you knew or had reason to know that there was "some" tax understatement on the return but were unaware of the extent of the understatement, innocent spouse relief is available for the liability attributable to the portion of the understatement that you did not know about or have reason to know about.
3. Taking all the circumstances into account, it would be inequitable to hold you liable for the tax. This test also applied under prior law. In deciding the "equity" issue, the IRS and courts consider the extent to which you benefitted from the tax underpayment, beyond receiving normal support. Thus, it is possible to be held liable for a tax understatement that you did not know about or have reason to know about, on the grounds that you benefitted from the underpayment in the form of a high standard of living. The IRS will also consider whether you later divorced or were deserted by your spouse.
4. You file an innocent spouse election with the IRS on Form 8857.

Election must be filed on Form 8857 to obtain relief. You must file an election on Form 8857 to claim innocent spouse relief. You do this by attaching a statement explaining why you qualify; follow the Form 8857 instructions. The election must be made no later than two years from the date that the IRS first begins collection activity (such as IRS garnishment of your wages) against you for tax due on the joint return. If the election is not made by the end of that two-year period, you will not be granted innocent spouse relief even if you meet the above qualification tests.

Tax Court appeal. If the IRS denies your election for innocent spouse relief, you have 90 days to petition the Tax Court for review. If you petition the Tax Court, the non-electing spouse has the right to intervene in the proceeding.

Did your spouse fail to pay the tax due on a correct return? Innocent spouse relief applies to tax understatements; that is, where the amount of tax shown on a joint return is incorrect. If the proper amount of tax liability is shown on the return but not paid, innocent spouse relief is not available. However, the IRS can provide equitable relief where innocent spouse relief is unavailable and it would be unfair to hold you liable *(1.9)*.

Planning Reminder

Deadline for Innocent Spouse Election

You have until two years from the date that the IRS first attempts to collect tax from you on the joint return to make an innocent spouse election.

1.8 Separate Liability Election for Former Spouses

If the IRS attempts to collect the taxes due on a joint return from you and you have since divorced or separated, you may be able to avoid or at least limit your liability by filing a separate liability election on Form 8857. If you qualify, you will be liable only for the part of the tax liability (plus interest and any penalties) that is allocable to you. If you make the election and a tax deficiency is entirely allocable to your former spouse under the rules discussed below, you will not have to pay any part of it. However, you may not avoid liability for any part of a tax deficiency allocable to the other spouse if you had actual knowledge of the income or expense item that gave rise to the tax deficiency that the IRS is trying to collect. *See* below for details of the knowledge test.

Furthermore, you may not avoid liability to the extent that certain disqualified property transfers were made between you and the other spouse. An election may be completely denied for both spouses if transfers were made as part of a fraudulent scheme.

As with innocent spouse relief *(1.7)*, the separate liability election applies only to tax understatements where the proper tax liability was *not* shown on the joint return. If the proper liability was shown but not paid, equitable relief *(1.9)* may be requested.

Are you eligible for the separate liability election? You may make the separate liability election on Form 8857 if at the time of the election:

1. You are divorced or legally separated from the spouse with whom you filed the joint return, *or*
2. You have not lived with your spouse (with whom you filed the return) at any time in the 12-month period ending on the date you file the election, *or*
3. The spouse with whom you filed the joint return has died.

   If you qualify under any of the above, you may make the separate liability election on Form 8857 by attaching a statement that identifies which items giving rise to the tax understatement are allocable to you and which are allocable to the other spouse. You do not have to actually compute your separate liability, however. You may make the separate liability election in addition to the innocent spouse election *(1.7)*.

Caution

Actual Knowledge Bars Relief

The separate liability election generally allows you to avoid liability for the portion of a tax deficiency that is allocable to the other spouse. Such relief is unavailable, however, to the extent that you had actual knowledge of the omitted income or deducted item that gave rise to the tax deficiency.

Timing of the election. The separate liability election must be filed with the IRS on Form 8857 no later than two years after the IRS begins collection activities against you.

Actual knowledge of the item allocable to the other spouse bars relief. If you elect separate liability treatment and the IRS shows that at the time you signed the joint return you had actual knowledge of an erroneous item (omitted income or improper deduction or credit) that would otherwise be allocated to the other spouse, you may not avoid liability for the portion of a deficiency attributable to that item. However, if you signed the return under duress, separate liability is not barred despite your knowledge.

The actual knowledge test is intended by Congress to be more favorable to the taxpayer than the "had reason to know" test under the innocent spouse rules *(1.7)*. Congressional committee reports state that the IRS is required to prove that an electing spouse had actual knowledge of an erroneous item and may not infer such knowledge. According to the Tax Court, the IRS must prove actual knowledge by a "preponderance of the evidence." If the IRS proves actual knowledge of an erroneous item, that item is treated as allocable to both spouses, so the IRS can collect that portion of the deficiency from either spouse.

However, there is a controversy as to how to apply the actual knowledge test. Taxpayers and commentators have argued that Congress intended separate liability relief to be available to a spouse unless she or he knew that the tax return was incorrect. The IRS position is that relief is barred to a spouse who had knowledge of the income or expenditure that gave rise to the tax deficiency, even if the electing spouse did not know that the entry on the return was incorrect. The Tax Court, the Fifth Circuit, and the District of Columbia Circuit agree with the IRS in cases involving omitted income; *see* Example 1 below.

In erroneous deduction cases, the Tax Court definition of "actual knowledge" is not as clear, but it has indicated that it will look at whether the electing spouse was aware of the "factual circumstances" that made the item nondeductible. If the electing spouse knew the factual basis for denial of the deduction, separate liability relief will be denied. In cases involving limited partnership tax-shelter deductions, the IRS may be unable to prove that an electing spouse had such disqualifying knowledge, but relief may still be partially denied if the spouse received a tax benefit from the deductions; *see* Example 3 below.

EXAMPLES

1. Cheshire knew that her husband had received an early retirement distribution. She knew that the distribution had been deposited into their joint account and used to pay off a mortgage, buy a truck, pay other family expenses and provide start-up capital for the husband's business. Cheshire's husband falsely told her that a CPA had determined that most of his retirement distribution was not taxable. After they divorced, Cheshire made a separate liability election to avoid tax on the unreported income. She claimed that she was entitled to relief because she did not know that the taxable amount of the retirement distribution had been misstated on their joint return. The Tax Court held that she could not obtain relief because she knew about the retirement distribution. It is immaterial that she did not know that the reporting of the distribution on the tax return was incorrect. The Court of Appeals for the Fifth Circuit affirmed. The District of Columbia Circuit has also denied a wife's claim for relief because she had actual knowledge of her husband's retirement income.
2. You file a joint return on which you report wages of $150,000 and your husband reports $30,000 of self-employment income. The IRS examines your return and determines that your husband failed to report $20,000 of income, resulting in a $9,000 deficiency. You file a separate liability election with the IRS after obtaining a divorce.

   Assume that the IRS proves that you had actual knowledge of $5,000 of the unreported income but not the other $15,000. You are liable for 25% of the deficiency, or $2,250, allocable to the $5,000 of income that you knew about ($2,250 = $5,000 × $20,000 × $9,000). Your former spouse is liable for the entire deficiency since the unreported income was his. The IRS can collect the entire deficiency from him, or can collect $2,250 from you and the balance from him.
3. Mora's husband arranged an investment in a cattle-breeding tax shelter partnership. He put the partnership in both of their names, although Mora did not sign any of the partnership papers. On their joint returns, they claimed partnership losses which turned out to be inflated; deductions were based on overvalued cattle. After their divorce, the IRS disallowed the partnership losses and Mora elected separate liability relief. The IRS refused, claiming that she participated in making the investment so the claimed losses were allocable to her as well as her husband. The Tax Court held that Mora was not involved in making the investment and so the partnership losses are allocable to the husband unless Mora knew the factual basis for the denial of the deductions or she received a tax benefit from the deductions. She did not know about the overvaluation of the cattle, which was the factual basis for the IRS's denial of the deductions. In fact, the IRS conceded that neither spouse understood the nature of their investment or the basis of the deductions. This may often be the case where passive investors claim deductions passed through to them by a limited partnership. For this reason, the IRS argued that the "knowledge of the factual basis" test makes it too easy for limited partnership investors to obtain relief. The Tax Court responded that the law does not distinguish between passive and active investments and there is no policy reason for the courts to create a distinction. Furthermore, although the husband also lacked knowledge of the factual basis for the disallowance of the losses, he cannot avoid liability for the deficiency since the erroneous deductions would be allocable to him on a separate return.

   Despite Mora's "win" on the actual knowledge issue, she remained partially liable for the deficiency because she received a tax benefit from the erroneous deductions. Under the tax benefit rule discussed below, the deductions first offset the income that would have been reported by the husband had he filed a separate return. The balance of the deductions benefitted Mora by reducing her separate return income. If she benefitted from 25% of the deductions, she would remain liable for 25% of the deficiency.

Allocating tax liability between spouses. Generally, if you make a separate liability election, you are liable only for the portion of the tax due on the joint return that is allocable to you, determined as if you had filed a separate return. If erroneous items (omitted income or improper deductions or credits) are allocable to the other spouse but you had actual knowledge of the items as discussed above, you cannot avoid liability and the IRS remains able to collect the tax due from either of you. Where deductions are allocable to the other spouse and you are not barred from relief by the actual knowledge test, you can still be held partially liable if you received a tax benefit from the deductions; *see* the discussion of the tax benefit rule below.

In general, the allocation of a tax deficiency depends on which spouse's "items" gave rise to the deficiency. The items may be omitted income or disallowed deductions or credits. Items are generally allocated to the spouse who would have reported them on a separate return. If a deficiency is based on unreported income, the deficiency is allocated to the spouse who earned the income. Income from a jointly owned business is allocated equally unless you provide evidence that more should be allocated to the other spouse. Similarly, if a deficiency is based on the denial of personal deductions, the deficiency is allocated equally between you unless you show that a different allocation is appropriate. A deficiency based on the denial of business deductions is allocated according to your respective ownership shares in the business. If the IRS can show fraud, it can reallocate joint return items.

On Form 8857, you do *not* have to figure the portion of the deficiency for which you are liable. The IRS will figure your separate liability (and any related interest and penalties). However, you can use a worksheet in IRS Publication 971 to figure your separate liability.

Planning Reminder

Unpaid Tax on Correct Return

The separate liability election is not available where the proper amount of tax was reported on a joint return but your spouse did not pay the tax. However, equitable relief *(1.9)* may be available in this type of tax underpayment situation.

EXAMPLES

1. After you obtain a divorce, the IRS examines a joint return you filed with your former husband and assesses a tax deficiency attributable to income he failed to report. If you did not know about the omitted income and timely elect separate liability treatment, you are not liable for any part of the tax deficiency, which is entirely allocable to your former husband who earned the income. You are not liable even if the IRS is unable to collect the tax from your former husband and you have substantial assets from which the tax could be paid.
2. The IRS assesses a joint return deficiency attributable to $35,000 of income that your former spouse failed to report and $15,000 of disallowed deductions that you claimed. Both of you may make the separate liability election and limit your respective liabilities.

   If you make the election, your liability will be limited to 30% of the deficiency, as your disallowed deductions of $15,000 are 30% of the $50,000 of items causing the deficiency. If your former husband makes the election, he will be liable for the remaining 70% of the deficiency (his $35,000 of unreported income is 70% of the $50,000 of items causing the deficiency).

   If either of you does not make the election, the non-electing person could be held liable for 100% of the deficiency unless innocent spouse relief is available or the IRS grants equitable relief.

Tax benefit rule limits relief based on erroneous deductions or credits. The tax benefit limitation is an exception to the general rule that allocates items between the spouses as if separate returns had been filed. If you received a tax benefit from an erroneous deduction or credit that is allocable to the other spouse, you remain liable for the proportionate part of the deficiency. You are treated as having received a tax benefit if the disallowed deduction exceeded the income that would have been reported by the other spouse on a hypothetical separate return.

EXAMPLE

On a joint return, you report wages of $100,000 and your husband reports $15,000 of self-employment income. You divorce the following year. The IRS examines the return and disallows a $20,000 business expense deduction claimed by your former husband, resulting in a $5,600 tax deficiency. You elect separate liability relief. Of the $20,000 deduction, $15,000 is allocable to your former husband as that amount offset his entire income. The $5,000 balance offset your separate income and thereby gave you a tax benefit. Your former husband will be liable for 75% of the deficiency ($4,200) and you will be liable for the 25% balance ($1,400).

If your former husband had reported income of $30,000 instead of $15,000, you would not be liable for any part of the deficiency under the tax benefit rule. The deduction is attributed entirely to his income, so the entire deficiency is allocated to him.

These allocations assume that the IRS does not show that you had "actual knowledge" (*see* above) of the deductions attributable to your former husband. To the extent you had such knowledge, the deductions are allocable to both of you, so both of you remain liable for that part of the deficiency.

Transfers intended to avoid tax. You may be held liable for more than your allocable share of a deficiency if a disqualified asset transfer was made to you by your spouse with a principal purpose of avoiding tax. Transfers made to you within the one-year period preceding the date on which the IRS sends the first letter of proposed deficiency are presumed to have a tax avoidance purpose unless they are pursuant to a divorce decree or decree of separate maintenance. You may rebut the presumption by showing that tax avoidance was not the principal purpose of the transfer. If the tax avoidance presumption is not rebutted, the transfer is considered a disqualified transfer and the value of the transferred asset adds to your share of the liability as otherwise determined under the above election rules.

If the IRS proves that you and your former spouse transferred assets between you as part of a fraudulent scheme, neither of you will be allowed to make the separate liability election; both of you will remain individually liable for the entire joint return deficiency.

Appeal to Tax Court. You may petition the Tax Court if the IRS disputes your election or your allocation of liability. The petition must be filed within 90 days of the date on which the IRS mails a determination to you by registered or certified mail if the IRS mailing is within six months of the filing of the election. If an IRS notice is not mailed within the six-month period, a Tax Court petition may be filed without waiting for an IRS response or, if you do wait, you have until 90 days after the date the IRS mails the notice to file the petition.

The IRS may not take any collection action against you during the 90-day period and if the Tax Court petition is filed, the suspension lasts until a final court decision is made.

1.9 Equitable Relief

The IRS may grant equitable relief for liability on a joint return where innocent spouse relief *(1.7)* and separate liability *(1.8)* are not available. For example, the separate liability election and innocent spouse relief are not available where the proper amount of tax was reported on a joint return but your spouse failed to pay the tax owed. If you signed a correct return on which tax was owed and, without your knowledge, your spouse used the funds intended for payment of the tax for other purposes, the IRS may grant you equitable relief. A request for equitable relief is made on Form 8857. The IRS may also grant equitable relief in cases where the proper amount of tax was understated on the joint return if it would be inequitable to hold you liable.

Threshold conditions you must meet for relief. Each of the following conditions must be met before the IRS will even consider granting you equitable relief:

1. You filed a joint return for the year that relief is sought.
2. Relief is not available under the innocent spouse *(1.7)* or separate liability election *(1.8)* rules.
3. No assets were transferred between you and your spouse as part of a fraudulent scheme.
4. Your spouse did not transfer assets to you for the purpose of tax avoidance. If there was such a transfer, relief can be granted only to the extent income tax liability exceeds the value of these assets.
5. You did not file or fail to file the return with fraudulent intent.
6. The income tax liability for which you are seeking relief is attributable to the other spouse (with whom the joint return was filed). There are exceptions to this requirement if community property law applies, you have nominal ownership of property subject to a deficiency, the other spouse misappropriated funds intended for payment of the tax without your knowledge, or you did not challenge the treatment of items on the joint return because of prior abuse that made you fear retaliation by the other spouse.

The IRS also required as a threshold condition that the request for equitable relief be made within two years of the first IRS collection activity. However, the Tax Court in a 2009 decision struck down the two-year limitation as being contrary to the statute authorizing equitable relief.

Safe harbor for tax liability reported on return but unpaid. The IRS will ordinarily grant you equitable relief for unpaid tax liability if when you filed for relief you were divorced, legally separated, or living apart from the other spouse for the 12-month period before your request, and both of the following tests are also met: (1) you would face economic hardship if forced to pay the tax, meaning that you would be unable to meet reasonable basic living expenses, and (2) you can show that at the time the joint return was filed, it was reasonable for you to believe that the other spouse would pay the tax liability.

Factors the IRS will consider. If the threshold conditions are satisfied and you do not qualify for relief under the safe harbor discussed in the preceding paragraph, you must convince the IRS that equitable relief is appropriate. The IRS will consider all the facts and circumstances.

The following is a nonexclusive list of factors that the IRS will take into account in determining whether to grant equitable relief: whether you are separated or divorced from the other spouse, whether you would suffer economic hardship (*i.e.,* be unable to meet basic living expenses), whether the other spouse was legally obligated to pay the outstanding liability, whether you received any significant benefit from the unpaid tax or item giving rise to the deficiency (beyond normal support), whether you have made a good faith effort to comply with the tax laws in later years. The case for relief is strengthened if there was a history of abuse by the other spouse or you were in poor health (physical or mental) at the time the return was filed.

The IRS will also consider whether you had knowledge or constructive knowledge (reason to know) that should bar relief. If the tax was properly reported but not paid, the IRS will look at whether you knew or had reason to know that it would not be paid by the other spouse. If the liability results from an IRS deficiency notice, the issue is whether you knew or had reason to know of the item (omitted income or erroneous deduction or credit) giving rise to the deficiency. Actual knowledge strongly weighs against relief, although relief may still be granted in limited cases where there are compelling grounds. If you had constructive knowledge—reason to know—of the item giving rise to the deficiency, this is considered a factor weighing against relief but it is not weighed more heavily than other factors. In determining constructive knowledge, the IRS will look at your level of education, your involvement in family finances and business matters, whether the other spouse deceived you, and whether there was an increase in lavish or unusual expenditures.

Appeal to Tax Court. If the IRS denies your request for equitable relief, you may petition the Tax Court for review of the IRS decision. The petition must be filed with the Tax Court no later than the 90th day after the date that the IRS mails its final determination notice to you.

How Widows and Widowers File

1.10 Death of Your Spouse in 2009

If your spouse died in 2009, you are considered married for the whole year. If you did not remarry in 2009, you may file a 2009 joint return for you and your deceased spouse. Generally, you file a joint return with the executor or administrator. But you alone may file a joint return if you are otherwise entitled to file jointly and:

1. The deceased did not file a separate return, and
2. Someone other than yourself has not been appointed as executor or administrator before the due date for filing the return. An executor or administrator appointed after the joint return is filed may revoke the joint return within the one-year period following the due date.

If you do file jointly, you include on the return all of your income and deductions for the full year and your deceased spouse's income and deductions *up to the date of death (1.14)*.

For 2010 and 2011, you may be able to file as a qualifying widow(er) if a dependent child lives with you *(1.11)*.

Joint return barred. As a surviving spouse, you may not file a joint return for you and your deceased spouse if:

1. You remarry before the end of the year of your spouse's death. In this case you may file jointly with your new spouse. A final return for the deceased spouse must be filed by the executor or administrator using the filing status of married filing separately.
2. You or your deceased spouse has a short year because of a change in annual accounting period.
3. Either of you was a nonresident alien at any time during the tax year; but *see 1.5*.

1040 *Filing Instruction*

Reporting Income of Deceased Spouse

If your spouse died during the year and you are filing a joint return, include his or her income earned through the date of death.

Planning Reminder

Possible Estate Insolvency

If you will be appointed executor or administrator and are concerned about estate insolvency, it may be advisable to hedge as follows: (1) File separate returns. If it is later seen that a joint return is preferable, you have three years to change to a joint return. (2) File jointly but postpone being appointed executor or administrator until after the due date of the joint return. In this way, the joint return may be disaffirmed if the estate cannot cover its share of the taxes.

Executor or administrator may revoke joint return. If an executor or administrator is later appointed, he or she may revoke a joint return that you alone have filed by filing a separate return for the decedent. Even if you have properly filed a joint return for you and the deceased spouse (as just discussed), the executor or administrator is given the right to revoke the joint return. But a state court held that a co-executrix could not refuse to sign a joint return where it would save the estate money.

To revoke the joint return, the executor must file a separate return within one year of the due date (including extensions). The executor's separate return is treated as a late return; interest charges and a late filing penalty apply. The joint return that you filed is deemed to be your separate return. Tax on that return is recalculated by excluding items belonging to your deceased spouse.

Signing the return. A joint return reporting your deceased spouse's income should list both of your names. Where there is an executor or administrator, the return is signed by you as the surviving spouse and the executor or administrator in his or her official capacity. If you are the executor or administrator, sign once as surviving spouse and again as the executor or administrator. Where there is no executor or administrator, you sign the return, followed by the words "filing as surviving spouse."

Surviving spouse's liability. If a joint return is filed and the estate cannot pay its share of the joint income tax liability, you, as the surviving spouse, may be liable for the full amount. Once the return is filed and the filing date passes, you can no longer change the joint return election and file a separate return unless an administrator or executor is appointed after the due date of the return.

In that case, as previously discussed, the executor may disaffirm the joint return.

1.11 Qualifying Widow(er) Status If Your Spouse Died in 2008 or 2007

If your spouse died in either 2008 or 2007 and you meet the following three requirements, your 2009 filing status is *qualifying widow or widower*, which allows you to use joint return rates on an individual return.

1. You did not remarry before 2010 (if you did remarry, you may file a 2009 joint return with your new spouse).
2. You may claim as your dependent *(21.1)* in 2009 a child, stepchild, or adopted child who lived with you during 2009 and you paid over half the cost of maintaining your home. The child must live with you for the entire year, not counting temporary absences such as to attend school or take a vacation. A foster child is not considered your child for purposes of these rules.
3. You were entitled to file jointly in the year of your spouse's death, even if you did not do so.

If you meet all these tests and do not itemize deductions (Schedule A, Form 1040), use the standard deduction for married couples filing jointly *(13.1)*. To figure your regular income tax liability, you generally use the IRS Tax Table or Tax Computation Worksheet *(22.2)* for qualifying widows or widowers, the same one used by married couples filing jointly.

Spouse's death before 2007. If your spouse died before 2007 and you did not remarry before 2010, you may be able to use head of household rates for 2009 if you qualify under the rules discussed in *1.12*.

Filing as Head of Household

1.12 Qualifying as Head of Household

You can file as "head of household" for 2009 if you are unmarried at the end of 2009 and you maintained a household for your child, parent, or other qualifying relative. You must be a U.S. citizen or resident *(18.1)* for the entire year. Tax rates are lower for a head of household than for a person filing as single *(1.2)* and the standard deduction is higher *(Chapter 13)*. If you are married but for the last half of 2009 you lived apart from your spouse, you may be treated as unmarried and able to qualify for head of household tax rates and standard deduction, which are more favorable than those for a married person filing separately; *see* Test 1 below.

Head of household tests. You must meet both of these tests to qualify as a head of household:

1. You were unmarried at the end of the year or treated as unmarried.
2. You paid more than half of the year's maintenance costs for the home of a qualifying person. A qualifying person other than your parent must live with you in that same house for over half the year, disregarding temporary absences. A qualifying parent does not have to live with you.

Details of the tests are in the following paragraphs.

Test 1: Are you unmarried? You are "unmarried" for 2009 head of household purposes if you are any one of the following:

- ***Single as of the end of 2009.***
- ***A widow or widower and your spouse died before 2009.*** If a dependent child lives with you, *see* 1.11 to determine if you may use the even more advantageous filing status of qualifying widow(er). If your spouse died in 2009, you are treated as married for the entire year and *cannot* qualify as a 2009 head of household, but a joint return may be filed *(1.10)*.
- ***Legally separated or divorced under a final court decree as of the end of 2009.*** A custody and support order does not qualify as a legal separation. A provisional decree (not final), such as a support order *pendente lite* (while action is pending) or a temporary order, has no effect for tax purposes until the decree is made final.
- ***Married but living apart from your spouse.*** You are considered unmarried for 2009 head of household purposes if your spouse was not a member of your household during the last six months of 2009, you file separate returns, and you maintain a household for more than half the year for a dependent child, stepchild, or adopted child. You are not considered to be "living apart" if you and your spouse lived under the same roof during the last six months of the year. A foster child qualifies if he or she was placed with you by an authorized placement agency, or by a court judgment, decree, or order. You must be able to claim the child as a dependent unless your spouse (the noncustodial parent) has the right to the exemption *(21.7)*.
- ***Married to an individual who was a nonresident alien during any part of 2009 and you do not elect to file a joint return reporting your joint worldwide income*** *(1.5)*.

Note: Same-sex marriages are *not* recognized as marriages under the federal tax law.

Test 2: Did you maintain a home for a qualifying person? You must pay more than half the costs of maintaining a home for a qualifying person.

Qualifying person. A child or relative can be your qualifying person for head of household purposes only if he or she is a qualifying child or relative under the exemption rules for dependents *(21.1)*. However, you may be eligible for head of household status even if you are unable to actually claim the person as your dependent. For example, an unmarried child who meets the definition of a qualifying child *(21.1)* but who cannot be claimed as your dependent because of one of the additional tests *(21.1)* is nonetheless a qualifying person for head of household purposes. If, under the special rules for divorced or separated parents *(21.7)*, you are the custodial parent and you waive your right to the exemption for your child in favor of the other parent, you may claim head of household status; the other parent may not.

A married child must be your dependent to be a qualifying person for head of household purposes unless the only reason you cannot claim the dependency exemption for the child is that you are the dependent of another taxpayer *(21.1)*.

Your parent or any other qualifying relative can be your qualifying person for head of household purposes only if you can claim an exemption for him or her as your dependent *(21.1)*. However, even if you can claim the exemption, you are not eligible for head of household status if the relative is your dependent only because (1) you have a multiple support agreement granting you the right to the exemption *(21.6)* or (2) he or she is your qualifying relative under the member-of-household test *(21.4)*.

Maintaining a household. For a qualifying person other than your parent, the home that you maintain must be the principal residence for both of you for more than half the year, disregarding temporary absences; *see* Example 2 below. If the qualifying person is your parent, it does not matter where he or she lives, so long as you pay more than half of the household costs.

Filing Tip

Advantages of Head of Household Status

Tax rates are lower for a head of household than for those filing as single. The standard deduction is also higher. For a married person who lived apart from his or her spouse during the last half of the year, qualifying as a head of household allows use of tax rates that are more favorable than those for married persons filing separately.

Planning Reminder

Special Separate Household Rule for Parent

If your dependent parent is the qualifying person, you may claim head of household status even if he or she does not live with you. You must pay over half of your parent's household expenses, whether your parent lives alone, with someone else, or in a senior citizens' residence.

You must pay for more than half of the rent, property taxes, mortgage interest, utilities, repairs, property insurance, domestic help, and food eaten in the home. Do not consider the rental value of the lodgings provided to the qualifying person or the cost of clothing, medical expenses, education, vacation costs, life insurance, or transportation you provide, or the value of your work around the house.

Temporary absences disregarded. In determining whether you and a qualifying person lived in the same home for more than half the year, temporary absences are ignored if the absence is due to illness, or being away at school, on a business trip, on vacation, serving in the military, or staying with a parent under a child custody agreement. The IRS requires that it be reasonable to expect your qualifying child or relative to return to your household after such a temporary absence, and that you continue to maintain the household during the temporary absence. Under this rule, you would lose the right to file as head of household if your qualifying person moved into his or her own permanent residence before the end of the year.

EXAMPLES

1. Your mother lived with your sister in your sister's apartment, which cost $12,000 to maintain in 2009. Of this amount, you contributed $7,000 and your sister $5,000. Your mother has no income and did not contribute any funds to the household. You qualify as head of household for 2009 because you paid over half the cost of maintaining the home for your mother, who qualifies as your dependent *(21.1)*. A child or dependent relative other than your parent would have to live with you to enable you to file as head of household.
2. Doctors advised McDonald that her mentally ill son might become self-sufficient if he lived in a separate residence, but one nearby enough for her to provide supervision. She took the advice and kept up a separate home for her son that was about a mile from her own home. She frequently spent nights at his home and he at hers. The Tax Court agreed with the IRS that McDonald could not file as head of household since her principal residence was not the same as her son's.

Tax Returns for Children

Caution

Kiddie Tax May Apply to Investment Income

If your child has 2009 investment income exceeding $1,900, his or her tax liability generally must be figured on Form 8615, and under the "kiddie tax" rules, the excess over $1,900 will be taxed at your top tax rate rather than at your child's rate. The kiddie tax applies to children under age 18, and also to children who at the end of the year are either age 18 or full-time students under age 24 if their earned income is no more than 50% of their total support for the year *(24.2)*.

1.13 Filing for Your Child

The income of your minor child is *not* included on your return unless you make a special election to report a child's investment income *(24.4)*. A minor is considered a taxpayer in his or her own right. If the child is required to file a return but is unable to do so because of age or for any other reason, the parent or guardian is responsible for filing the return.

A tax return must be filed for a dependent child who had more than $950 of investment income and no earned income (for personal services) for 2009. If your child had only earned income (for personal services) and no investment income, a tax return must be filed if the earned income exceeded $5,700. *See* page 4 for further filing threshold rules.

If the child is unable to sign the return, the parent or guardian should sign the child's name in the proper place, followed by the words, "by [signature], parent [or guardian] for minor child." A parent is liable for tax due on pay earned by the child for services, but not on investment income.

A child who is not required to file a return should still do so for a refund of taxes withheld.

Social Security numbers. A parent or guardian must obtain a Social Security number for a child before filing the child's first income tax return. The child's Social Security number must also be provided to banks, brokers, and other payers of interest and dividends to avoid penalties and backup withholding *(26.12)*. To obtain a Social Security number, file Form SS-5 with your local Social Security office. If you have applied for a Social Security number but not yet received it by the filing due date, write "applied for" on the tax return in the space provided for the number.

Whether or not you are filing a return for a child, you must obtain and report on your return a Social Security number for a child whom you are claiming as a dependent *(21.1)*.

Wages you pay your children. You may deduct wages paid to your children in your business. Keep records showing that their activities are of a business rather than personal nature.

Withholding for children. Children with wages are generally subject to withholding and should file Form W-4 with their employer. An exemption from withholding may be claimed only in limited cases. The child must certify on Form W-4 that he or she had no federal tax liability in the prior year and expects no liability in the current year for which the withholding exemption is sought. For example, on Form W-4 for 2009, a child with investment income exceeding $300 who expected to be claimed as another taxpayer's dependent could claim an exemption from withholding only if the expected amount of investment income plus wages was $950 or less (this amount may change annually).

Wages you pay to your own children under age 18 for working in your business are not subject to FICA taxes (Social Security and Medicare) *(26.9)*.

Filing for a Deceased or Incompetent Person

1.14 Return for Deceased

When a person dies, another tax-paying entity is created—the decedent's estate. Until the estate is fully distributed, it will generally earn income for which a return must be filed. For example, Carlos Perez dies on June 30, 2009. The wages and bank interest he earned through June 30 are reported on his final income tax return, Form 1040, which is due by April 15, 2010. Interest earned on his bank account after June 30 is attributed to the estate, or to the account beneficiary if the right to the account passes by law directly to the account beneficiary. Income received by the estate is reported on Form 1041, the income tax return for the estate, if the estate has gross income of $600 or more. If Carlos was married, his surviving spouse could file a joint return *(1.10)* for 2008 and include all of Carlos's earnings through June 30. If she jointly owned the bank account with Carlos, the interest after as well as before June 30 could be reported on their joint return.

What income tax returns must be filed on behalf of the deceased? If the individual died after the close of the taxable year but before the income tax return was filed, the following must be filed:

1. Income tax return for the prior year;
2. Final income tax return, covering earnings in the period from the beginning of the taxable year to the date of death; *and*
3. Estate income tax return, covering earnings in the period after the decedent's death.

If the individual died after filing a return for the prior tax year, then only 2 and 3 are filed.

EXAMPLE

Steven Jones died on January 31, 2010, before he could file his 2009 tax return. His 2009 income tax return must be filed by April 15, 2010, unless an extension is obtained. A final income tax return to report earnings from January 1, 2010, through January 31, 2010, will have to be filed by April 15, 2011. Jones's estate will have to file an income tax return on Form 1041 to report earnings and other income that were not earned by Jones before February 1, 2010, unless the gross income of the estate is under $600.

Who is responsible for filing? The executor, administrator, or other legal representative is responsible for filing all returns. For purposes of determining whether a final income tax return for the decedent is due, the annual gross income test at page 3 is considered in full. You do not prorate it according to the part of the year the decedent lived. A surviving spouse may assume responsibility for filing a joint return for the year of death if no executor or administrator has been appointed and other tests are met *(1.10)*. However, if a legal representative has been appointed, he or she must give the surviving spouse consent to file a joint return for the year of the decedent's death. In one case, a state court held that a co-executrix could not refuse consent and was required to sign a joint return where it would save the estate money.

How do you report the decedent's income and deductions? You follow the method used by the decedent during his or her life, either the cash method or the accrual method, to account for the income up to the date of death. The income does not have to be put on an annual basis. Each item is taxed in the same manner as it would have been taxed had the decedent lived for the entire year.

If the decedent owned U.S. Savings Bonds, *see 4.29*.

Planning Reminder

Promptly Closing the Estate

To expedite the closing of the decedent's estate, an executor or other personal representative of the decedent may file Form 4810 for a prompt assessment. Once filed, the IRS has 18 months to assess additional taxes. The request does not extend the assessment period beyond the regular limit, which is three years from the date the return was filed. Form 4810 must be filed separately from the final return.

When one spouse dies in a community property state *(1.6)*, how should the income from the community property be reported during the administration of the estate? The IRS says that half the income is the estate's and the other half belongs to the surviving spouse.

Deductible expenses paid (or accrued under the accrual method) by the decedent before death are claimed on the final return.

Medical expenses of the decedent. If the estate pays the decedent's personal medical expenses (not those for the decedent's dependents) within one year of the date of death, the expenses can be deducted on the decedent's final return, subject to the regular 7.5% of adjusted gross income floor *(17.8)*. However, the expenses are not deductible for income tax purposes if they are deducted for estate tax purposes. To deduct such medical expenses on the decedent's final return, a statement must be attached to the final return affirming that no estate tax deduction has been taken and that the rights to the deduction have been waived.

Partnership income. The death of a partner closes the partnership tax year for that partner. The final return for the partner must include his or her distributive share of partnership income and deductions for the part of the partnership's tax year ending on the date of death. Thus, if a partner dies on July 26, 2009, and the partnership's taxable year ends December 31, 2009, the partner's final 2009 return must include partnership items for January 1, 2009 through July 26, 2009. Partnership items for the balance of 2009 must be reported by the partner's executor or other successor in interest on the estate's income tax return.

Exemptions allowed on a final return. These are generally the same exemptions the decedent would have had if he or she had not died *(21.1)*. You do not reduce the exemptions because of the shorter taxable year.

Estimated taxes. No estimated tax need be paid by the executor after the death of an unmarried individual; the entire tax is paid when filing the final tax return. But where the deceased and a surviving spouse paid estimated tax jointly, the rule is different. The surviving spouse is still liable for the balance of the estimated tax unless an amended estimated tax voucher is filed. Further, if the surviving spouse plans to file a joint return *(1.10)* that includes the decedent's income, estimated tax payments may be required; *see Chapter 27*.

Where the estate has gross income, estimated tax installments are not required on Form 1041-ES for the first two years after the decedent's death.

Signing the return. An executor or administrator of the estate signs the return. If it is a joint return, *see 1.10*.

When a refund is due on a final return. The decedent's final return may also be used as a claim for a refund of an overpayment of withheld or estimated taxes. Form 1310 may be used to get the refund, but the form is not required if you are a surviving spouse filing a joint return for the year your spouse died. If you are an executor or administrator of the estate and you are filing Form 1040, 1040A, or 1040EZ for the decedent, you do not need Form 1310, but you must attach to the return a copy of the court certificate showing your appointment as personal representative.

Itemized deduction for IRD subject to estate tax. Items of gross income that the decedent had a right to receive but did not receive before death (or accrue if under the accrual method) are subject to income tax when received by the estate or beneficiary. This "income in respect of a decedent," or IRD, is also included in the decedent's estate for estate tax purposes. If estate tax is paid, an individual beneficiary may claim an itemized deduction for an allocable share of the estate tax paid on IRD items; *see 11.17* for deduction details.

1040 *Filing Instruction*

IRD Not Included on Decedent's Final Return

Do not report on the decedent's final return income that is received after his or her death, or accrues after or because of death if the decedent used the accrual method. This income is considered "income in respect of a decedent," or IRD *(11.16)*. IRD is taxed to the estate or beneficiary receiving the income in the year of the receipt. On the decedent's final return, only deductible expenses paid up to and including the date of death may be claimed. If the decedent reported on the accrual basis, those deductions accruable up to and including the date of death are deductible. If a check for payment of a deductible item was delivered or mailed before the date of the decedent's death, a deduction is allowable on the decedent's last return, even though the check was not cashed or deposited until after the decedent's death. If the check was not honored by the bank, the item is not deductible.

1.15 Return for an Incompetent Person

A legal guardian of an incompetent person files Form 1040 for an incompetent whose gross income meets the filing tests on page 3. Where a spouse becomes incompetent, the IRS says the other spouse may file a return for the incompetent without a power of attorney, if no legal guardian has been appointed. For example, during the period an individual was in a mental hospital, and before he was adjudged legally incompetent, his wife continued to operate his business. She filed an income tax return for him and signed it for him although she had no power of attorney. The IRS accepted the return as properly filed. Until a legal guardian was appointed, she was charged with the care of her husband and his property.

The IRS has accepted a joint return filed by a wife in her capacity as legal guardian for her missing husband. However, the Tax Court has held that where one spouse is mentally incompetent, a joint return may not be filed because the incompetent spouse was unable to consent to a joint return; an appeals court agreed.

How Resident and Nonresident Aliens File

1.16 How a Nonresident Alien Is Taxed

A nonresident alien is generally taxed only on income from U.S. sources. A nonresident alien's income that is effectively connected with a U.S. business and capital gains from the sale of U.S. real property interests are subject to tax at regular U.S. rates. Other capital gains are not taxed unless a nonresident alien has a U.S. business or is in the U.S. for 183 days during the year. Generally, investment income of a nonresident alien from U.S. sources that is not effectively connected with a U.S. business is subject to a 30% tax rate (or lower rate if provided by treaty).

Nonresident aliens who are required to file must do so on Form 1040NR. If you are a nonresident alien, get a copy of IRS Publication 519, U.S. Tax Guide for Aliens. It explains how nonresident aliens pay U.S. tax.

Dual status. In the year a person arrives in or departs from the U.S., both resident and nonresident status may apply.

EXAMPLE

On May 1, 2009, Leon Marchand arrived on a non-immigrant visa and was present in the U.S. for the rest of the year. From January 1 to April 30, 2009, he is a nonresident; from May 1 to the end of the year, he is a resident, under the 183-day test *(1.18)*. Despite "dual status," he does not file two returns. Since he is a U.S. resident on the last day of the year, he files Form 1040 and reports income on the basis of his status for each part of the year. He writes "Dual-Status Return" across the top of the Form 1040. The income for the nonresident portion of the year should be shown on Form 1040NR (or, if eligible, Form 1040NR-EZ) and "Dual-Status Statement" marked across the top.

Certain restrictions apply to dual status taxpayers. For example, a joint return may not be filed, unless you and your spouse agree to be taxed as U.S. residents for the entire year.

For details on filing a return for a dual status year, *see* IRS Publication 519 and the instructions to Form 1040NR.

Caution

Who Is a Resident?

An alien's mere presence in the U.S. does not make him or her a "resident." An alien is generally treated as a "resident" only if he or she is a lawful permanent resident who has a "green card" or meets a substantial presence test *(1.18)*.

1.17 How a Resident Alien Is Taxed

A resident alien *(1.18)* is taxed on worldwide income from all sources, just like a U.S. citizen. The exclusion for foreign earned income may be claimed if the foreign physical presence test is satisfied or if the bona fide residence test is met by an individual residing in a treaty country *(36.5)*. A resident alien may generally claim a foreign tax credit *(36.14)*. A resident alien's pension from a foreign government is subject to regular U.S. tax. A resident alien working in the United States for a foreign government is not taxed on the wages if the foreign government allows a similar exemption to U.S. citizens.

1.18 Who Is a Resident Alien?

The following tests determine whether an alien is taxed as a U.S. resident. Intent to remain in the U.S. is not considered.

You are treated as a resident alien and taxed as a U.S. resident for 2009 tax purposes if you meet either of the following tests:

1. You have been issued a "green card," which grants you the status of lawful permanent resident. If you were outside the U.S. for part of 2009 and then became a lawful permanent resident, *see* the rules below for dual tax status.
2. You meet a 183-day substantial presence test. Under this test, you are treated as a U.S. resident if you were in the U.S. for at least 31 days during the calendar year and have been in the U.S. for at least 183 days within the last three years (the current year and the two preceding calendar years). The 183-day test is complicated and there are several exceptions.

Planning Reminder

Is 2009 Your First Year of Residency?

If you were not a resident during 2008 but in 2009 you satisfy both the lawful resident (green card) test and the 183-day presence test, your residence begins on the earlier of the first day you are in the U.S. while a lawful permanent resident and the first day of physical presence.

To determine if you meet the 183-day test for 2009, the following cumulative times are totaled. Each day in the U.S. during 2009 is counted as a full day. Each day in 2008 counts as ⅓ of a day; each day in 2007 counts as $^{1}/_{6}$ of a day. Note that you must be physically present in the U.S. for at least 31 days in the current year. If you are not, the 183-day test does not apply.

Other exceptions to the substantial presence test are: commuting from Canada or Mexico; keeping a tax home and close contacts or connections in a foreign country; having a diplomat, teacher, trainee, or student status; being a professional athlete temporarily in the U.S. to compete in a charitable sports event; or being confined in the U.S. for certain medical reasons. These exceptions are explained in the following paragraphs.

Commute from Mexico or Canada. If you regularly commute to work in the U.S. from Mexico or Canada, commuting days do not count as days of physical presence for the 183-day test.

Tax home/closer connection exception. If you are in the United States for less than 183 days during 2009, show that you had a closer connection with a foreign country than with the U.S., and keep a tax home there for the year, you generally will not be subject to tax as a U.S. resident even if you meet the substantial presence test. Under this exception, it is possible to have a U.S. abode and a tax home in a foreign country. A tax home is usually where a person has his or her principal place of business; if there is no principal place of business, it is the place of regular abode. Proving a tax home alone is not sufficient; the closer connection relationship must also be shown.

To claim the closer connection exception, you must file Form 8840 explaining the basis of your claim. The tax home/closer connection exception does not apply to an alien who is present for 183 days or more during a year or who has applied for a "green card." A relative's application is not considered as the alien's application.

Exempt-person exception. Days of presence in the U.S. are not counted under the 183-day test if you are considered an exempt person such as a teacher, trainee, student, foreign-government-related person, or professional athlete temporarily in the U.S. to compete in a charitable sports event.

To exclude days of presence as a teacher, trainee, student, or professional athlete, you must file Form 8843 with the IRS.

A foreign-government-related person is any individual temporarily present in the U.S. who (1) has diplomatic status or a visa that the Secretary of the Treasury (after consultation with the Secretary of State) determined represents full-time diplomatic or consular status; or (2) is a full-time employee of an international organization; or (3) is a member of the immediate family of a diplomat or international organization employee.

A teacher or trainee is any individual other than a student who is temporarily present in the U.S. under a "J" or "Q" visa and who substantially complies with the requirements for being so present.

A student is any individual who is temporarily present in the U.S. under either an "F," "J," "M," or "Q" visa and who substantially complies with the requirements for being so present.

The exception generally does not apply to a teacher or trainee who has been exempt as a teacher, trainee, or student for any part of two of the six preceding calendar years. However, if during the period you are temporarily present in the U.S. under an "F," "J," "M," or "Q" visa and all of your compensation is received from outside the U.S., you may qualify for the exception if you were exempt as a teacher, trainee, or student for less than four years in the six preceding calendar years. The exception also does not apply to a student who has been exempt as a teacher, trainee, or student for more than five calendar years, unless you show that you do not intend to reside permanently in the U.S. and that you have substantially complied with the requirements of the student visa providing for temporary presence in the U.S.

Medical exception. If you plan to leave but cannot physically leave the U.S. because of a medical condition that arose in the U.S., you may be treated as a nonresident, even if present here for more than 183 days during the year. You must file Form 8843 to claim the medical exception.

Tax treaty exceptions. The lawful permanent residence test and the substantial physical presence test do not override tax treaty definitions of residence. Thus, you may be protected by a tax treaty from being treated as a U.S. resident even if you would be treated as a resident under either test.

Dual tax status in first year of residency. If you first became a lawful permanent resident of the U.S. (received a green card) during 2009 and were not a U.S. resident during 2008, your period of U.S. residency begins with the first day in 2009 that you are present in the U.S. with the status of lawful permanent resident. Before that date, you are a nonresident alien. This means that if you become a lawful permanent resident during 2009 and remain a resident at the end of the year, you have a dual status tax year. On Form 1040, you attach a separate statement showing the income for the part of the year you are a nonresident. Form 1040NR (or 1040NR-EZ) may be used as the statement. Write "Dual-Status Return" or "Dual-Status Statement" across the top, as applicable.

To figure tax for a dual status year, *see* IRS Publication 519 and the instructions to Form 1040NR.

You also may have a dual status year if you were not a U.S. resident in 2008, and in 2009 you are a U.S. resident under the 183-day presence test. Your period of U.S. residency starts on the first day in 2009 for which you were physically present; before that date you are treated as a nonresident alien. However, if you meet the 183-day presence test (but not the green card test) and also spent 10 or fewer days in the U.S. during a period in which you had a closer connection to a foreign country than to the U.S., you may disregard the 10-day period. The purpose of this exception is to allow a brief presence in the U.S. for business trips or house hunting before the U.S. residency period starts.

If you are married at the end of the year to a U.S. citizen or resident alien, you and your spouse may elect to be treated as U.S. residents for the entire year by reporting your worldwide income on a joint return. You must attach to the joint return a statement signed by both of you that you are choosing to be treated as full-year U.S. residents.

EXAMPLES

1. Manuel Riveras, who has never before been a U.S. resident, lives in Spain until May 15, 2009. He moves to the U.S. and remains in the U.S. through the end of the year, thereby satisfying the physical presence test. On May 15, he is a U.S. resident. However, for the period before May 15, he is taxed as a nonresident.
2. Same facts as in Example 1, but Riveras attends a meeting in the U.S. on February 2 through 8. On May 15, he moves to the U.S.; May 15, not February 2, is the starting date of the residency. During February, he had closer connection to Spain than to the U.S. Thus, his short stay in February is an exempt period.

First-year choice. If you do not meet either the green card test or the 183-day substantial presence test for the year of your arrival in the U.S. or for the immediately preceding year, but you do meet the substantial presence test for the year immediately following the year of your arrival, you may elect to be treated as a U.S. resident for part of the year of your arrival. To do this, you must (1) be present in the U.S. for at least 31 consecutive days in the year of your arrival; and (2) be present in the U.S. for at least 75% of the number of days beginning with the first day of the 31-consecutive-day period and ending with the last day of the year of arrival. For purposes of this 75% requirement, you may treat up to five days of absence from the U.S. as days of presence within the U.S.

Do not count as days of presence in the U.S. days for which you are an *exempt individual* as discussed earlier.

You make the first-year election to be treated as a U.S. resident by attaching a statement to Form 1040 for the year of your arrival. A first-year election, once made, may not be revoked without the consent of the IRS.

If you make the election, your residence starting date for the year of your arrival is the first day of the earliest 31-consecutive-day period of presence that you use to qualify for the choice. You are treated as a U.S. resident for the remainder of the year.

Last year of residence. You are no longer treated as a U.S. resident as of your residency termination date. If you do not have a green card but are a U.S. resident for the year under the 183-day presence test, and you leave the U.S. during that year, your residency termination date is the last day you are present in the U.S., provided that: (1) after leaving the U.S. you had a closer connection to a foreign country than to the U.S. and had your tax home in that foreign country for the rest of the year, and (2) you are not treated as a U.S. resident for any part of the next calendar year.

If during the year you give up your green card (lawful permanent resident status) and meet tests (1) and (2), your residency termination date is the first day that you are no longer a lawful permanent resident. If during the year you meet both the green card test and the 183-day presence test and meet tests (1) and (2), your residency termination date is the *later* of the last day of U.S. presence or the first day you are no longer a lawful permanent resident. If tests (1) and (2) are not met, the residency termination date is the last day of the calendar year. In the year of your residency termination date, the filing rules for dual status taxpayers in this section apply.

For the year you give up your residence in the United States, you must file Form 1040NR (or Form 1040NR-EZ if eligible) and write "Dual-Status Return" across the top. Attach Form 1040 (or other statement) to show the income for the part of the year you are a resident; across the top write "Dual-Status Statement." *See* the instructions to Form 1040NR and IRS Publication 519 for filing the dual status return.

1.19 When an Alien Leaves the United States

Current law generally requires an alien who leaves the U.S., regardless of how long the trip is, to obtain a "sailing" or "departure" permit, technically known as a "certificate of compliance." The permit states that you have fulfilled your income tax obligations to the U.S. Without it, unless you are excused from obtaining one, you will be required at your point of departure to file a tax return and pay any tax due or post a bond. Diplomats, employees of international organizations or foreign governments, and students are generally exempt from the permit requirement. If a permit is required, Form 1040-C or in some cases a shorter Form 2063 must be filed with the IRS. *See* Publication 519 for further details.

Planning Reminder

Departure Permit

An alien planning to leave the U.S. should obtain a copy of Form 1040-C from the IRS to review his or her tax reporting obligations.

1.20 Expatriation Tax

In 2008, Congress again revised the tax consequences for U.S. citizens who relinquish their citizenship and long-term U.S. residents who end their residency. The Heroes Earnings Assistance and Relief Tax Act of 2008 enacted Code Section 877A, which provides a "mark-to-market" tax on unrealized gains of individuals whose expatriation date is on or after June 17, 2008. The prior law rules of Section 877 continue to apply to individuals who expatriated after June 3, 2004 but before June 17, 2008.

In general, individuals covered under the Section 877A rules are the same as those covered under Section 877. The rules apply to an expatriate or former long-term resident who (1) had average annual net income tax liability for the five years ending before the date of expatriation or termination of residency in excess of an annual ceiling, which for 2009 was $145,000; or (2) had net worth of $2 million or more when citizenship or residency ended; or (3) fails to certify under penalty of perjury on Form 8854 that he or she complied with all U.S. federal tax obligations for the five years preceding the date of expatriation or termination of residency. For purposes of both Section 877 and Section 877A, a long-term resident is someone who gives up lawful permanent residency ("green card") after holding it for at least eight of the prior 15 years. Each set of rules has exceptions, which vary somewhat, for individuals born with dual citizenship and those who relinquish citizenship before age 18½.

Law Alert

Recipients Taxed on Certain Gifts and Bequests From Expatriates

A U.S. citizen or resident may have to pay tax on a gift or bequest received on or after June 17, 2008 from an individual (or estate of an individual) who expatriates on or after June 17, 2008 and is subject to the rules of Section 877A. The tax does not apply to the extent that gifts or bequests during the year are within the annual gift tax exclusion ($13,000 for 2009). The tax also does not apply if the transfer is reported on a timely filed gift tax return or estate tax return, or to transfers qualifying for the gift/estate tax marital deduction or charitable deduction. The value of a transfer not covered by an exception is taxable to the recipient at the highest rate on taxable gifts or estates, which is 45% for 2009. A gift or bequest to a domestic trust is also subject to the tax, payable by the trust. If the gift or bequest is to a foreign trust, a U.S. citizen or resident pays the tax when distributions from the trust are received.

Section 877A. For individuals who expatriate on or after June 17, 2008, Section 877A imposes a "mark-to-market" tax. The expatriate is treated as selling all assets for their fair market value on the day before the expatriation date, and any net gain on the deemed sales in excess of an annual floor, which for 2009 is $626,000, is immediately taxed. Losses are taken into account and the wash sale rules do not apply. An election can be made to defer the tax on the deemed sales until the asset is sold (or death, if sooner) provided a bond or other security is provided to the IRS. Deferred compensation items and interests in nongrantor trusts are not subject to the mark-to-market tax, but are generally subject to a withholding tax of 30% on distributions to the expatriate. IRAs and certain other tax-deferred accounts are treated as if they were completely distributed on the day before the expatriation date, but early distribution penalties do not apply.

Section 877. Individuals who expatriated after June 3, 2004 but before June 17, 2008 are subject to tax on U.S. source income for 10 years following the relinquishment of citizenship or termination of long-term residency.

IRS Form 8854. The instructions to Form 8854 and Publication 519 have details on the expatriate tax rules, including the rules for determining when a U.S. citizen relinquishes his or her citizenship and on when an individual ceases to be a long-term resident.