

## Section 6402.—Authority to Make Credits or Refunds

26 CFR 301.6402-1: Authority to make credits or refunds.

**Offsets under section 6402; Arizona and Wisconsin law.** This ruling provides guidance regarding the amount of an overpayment from a joint tax return that the IRS may offset against a spouse's separate tax liability for taxpayers domiciled in Arizona or Wisconsin. Arizona and Wisconsin are community property states and, under the respective state laws, each spouse has an undivided 50-percent interest in all community property. Rev. Ruls. 80-7 and 85-70 amplified and clarified.

### Rev. Rul. 2004-71

#### ISSUE

What amount of an overpayment reported on a joint return may the Internal Revenue Service apply against one spouse's separate tax liability if the spouses are domiciled in Arizona or Wisconsin?

This ruling addresses how offsets apply for taxpayers filing joint returns and domiciled in Arizona or Wisconsin. Because these states have similar community property laws, Arizona and Wisconsin are addressed in one ruling. This ruling

makes assumptions about the operation of state community property laws which are highly dependent on facts and circumstances. Therefore, taxpayers are cautioned to check current state law and apply it to their particular facts. Taxpayers domiciled in California, Idaho, or Louisiana should refer to Rev. Rul. 2004-72; taxpayers domiciled in Nevada, New Mexico or Washington should refer to Rev. Rul. 2004-73; and taxpayers domiciled in Texas should refer to Rev. Rul. 2004-74.

#### FACTS

*Situation 1, Arizona.* In Year 1, Liable Spouse, who is single, incurs a tax liability of \$20,000. Liable Spouse does not pay this tax liability. In Year 2, Liable Spouse and Non-Liable Spouse marry. In Year 4, Liable Spouse and Non-Liable Spouse file a joint return for Year 3, reporting an overpayment of \$1,000. The overpayment results from income taxes withheld from Liable Spouse's and Non-Liable Spouse's wages during Year 3. Liable Spouse and Non-Liable Spouse are domiciled in Arizona at all relevant times. The tax liability incurred by Liable Spouse for Year 1 is a separate debt under Arizona law. Applying Rev. Rul. 80-7, 1980-1 C.B. 296, the Service determines that \$750 of the overpayment is attributable to income taxes withheld from Liable Spouse's wages, and \$250 of the overpayment is attributable to income taxes withheld from Non-Liable Spouse's wages.

Arizona law provides that community property is all property acquired during marriage, except for property acquired by a spouse by gift, devise, or descent. *See* Ariz. Rev. Stat. section 25-211 (2003). There is a rebuttable presumption under Arizona law that all property acquired during marriage is community property. *See Mitchell v. Mitchell*, 732 P.2d 208, 212

(Ariz. 1987) (en banc). Arizona law defines separate property as property owned by a spouse before marriage and property acquired during marriage by a spouse by gift, devise, or descent. *See* Ariz. Rev. Stat. section 25-213 (2003). In addition, separate property includes any profits or income derived from separate property during marriage. *See* Ariz. Rev. Stat. section 25-213 (2003).

Arizona law provides that a creditor may reach all of the liable spouse's separate property and all of the community property to satisfy a community debt. *See* Ariz. Rev. Stat. section 25-215(D) (2003). In addition, a creditor may reach all community property that would have been the liable spouse's separate property but for marriage and all of the liable spouse's separate property to satisfy a separate debt. *See* Ariz. Rev. Stat. section 25-215(B) (2003). Further, the Service may reach the liable spouse's interest in any community property that would have been the non-liable spouse's separate property but for marriage to satisfy a separate debt of the liable spouse. *In re Ackerman*, 424 F.2d 1148 (9<sup>th</sup> Cir. 1970). However, a creditor may not reach any of the non-liable spouse's separate property to satisfy the liable spouse's separate debt. *See* Ariz. Rev. Stat. section 25-215(A) (2003).

Under Arizona law, community debts are debts incurred during marriage for the benefit of the community. *See* Ariz. Rev. Stat. section 25-215(D) (2003); *Johnson v. Johnson*, 638 P.2d 705, 711-712 (Ariz. 1981). Arizona law presumes that a debt incurred by a spouse during marriage is a community debt. *See In re Marriage of Hrudka*, 919 P.2d 179, 186-187 (Ariz. Ct. App. 1995). If a debt is not a community debt, then it is a separate debt. *See id.* at 187.

*Situation 2, Wisconsin.* In Year 1, Liable Spouse, who is single, incurs a tax

liability of \$20,000. Liable Spouse does not pay this tax liability. In Year 2, Liable Spouse and Non-Liable Spouse marry. In Year 4, Liable Spouse and Non-Liable Spouse file a joint return for Year 3, reporting an overpayment of \$1,000. The overpayment results from income taxes withheld from Liable Spouse's and Non-Liable Spouse's wages during Year 3. Liable Spouse and Non-Liable Spouse are domiciled in Wisconsin at all relevant times. The tax liability incurred by Liable Spouse for Year 1 is a liability incurred before marriage that is attributable to action or inaction before marriage under Wisconsin law. Applying Rev. Rul. 80-7, 1980-1 C.B. 296, the Service determines that \$750 of the overpayment is attributable to income taxes withheld from Liable Spouse's wages, and \$250 of the overpayment is attributable to income taxes withheld from Non-Liable Spouse's wages.

Wisconsin law classifies property owned by a spouse as either marital property or individual property. See Wis. Stat. section 766.31 (2002). Marital property is a form of community property, and each spouse has a 50 percent interest in the marital property. See Wis. Stat. section 766.31(3) (2002); Rev. Rul. 87-13, 1987-1 C.B. 20. Marital property includes all property that is not individual property and that was acquired after the determination date. See Wis. Stat. section 766.31 (2002). The determination date is the latest of either: (1) the date of marriage; (2) the date both spouses are domiciled in Wisconsin; or (3) January 1, 1986. See Wis. Stat. section 766.01(5) (2002). Wisconsin law presumes that all property owned by a spouse is marital property. See Wis. Stat. section 766.31(2) (2002). This presumption may be rebutted. See *Lloyd v. Lloyd*, 487 N.W.2d 647, 652 (Wis. Ct. App. 1992).

Wisconsin law defines individual property as property owned by a spouse before the determination date. See Wis. Stat. section 766.31(9) (2002). In addition, individual property includes property acquired during marriage and after the determination date if the property is: (1) received by gift, bequest, or devise to one spouse; (2) income paid to one spouse from a trust, unless the trust provides otherwise; (3) received in exchange for or obtained with the proceeds of other individual property;

(4) designated as individual property by decree, marital property agreement, or reclassification pursuant to Wis. Stat. section 766.31(10); or (5) recovered for personal injury. See Wis. Stat. section 766.31(7) (2002).

Wisconsin law classifies debts incurred by a spouse into three separate categories: (1) debts incurred before or during marriage that are attributable to action or inaction before marriage; (2) debts incurred during marriage for the benefit of the marriage or family; and (3) debts incurred during marriage that are not for the benefit of marriage or family. See Wis. Stat. section 766.55 (2002). Wisconsin law presumes that a debt incurred during marriage is for the benefit of the marriage or the family. See Wis. Stat. section 766.55(1) (2002). If a spouse before marriage or during marriage incurs a debt that is attributable to action or inaction before marriage, Wisconsin law allows that spouse's creditor to reach all marital property that would have been that spouse's individual property but for the marriage and all individual property of that spouse. See Wis. Stat. section 766.55(2)(c)(1) (2002). Further, Wisconsin law allows the Service to reach the liable spouse's interest in any marital property that would have been the non-liable spouse's individual property but for marriage. *Vorhies v. Z. Management*, Civil No. 86-C695-S (W.D. Wis. 1987). If a spouse incurs a debt for the benefit of the marriage or the family, Wisconsin law allows a creditor to reach all marital property and all individual property of that spouse. See Wis. Stat. section 766.55(2)(b) (2002); *Sokaogon Gaming Ent. v. Curda-Derickson*, 668 N.W.2d 736 (Wis. Ct. App. 2003). If a debt incurred by a spouse was not for the benefit of the marriage or the family, Wisconsin law allows a creditor to reach that spouse's individual property and interest in marital property. See Wis. Stat. section 766.55(2)(d) (2002).

*Situation 3, Wisconsin.* Liable Spouse and Non-Liable Spouse are domiciled in Wisconsin at all relevant times. In Year 1, Liable Spouse and Non-Liable spouse are single and have no outstanding tax liabilities. In Year 2, Liable Spouse and Non-Liable Spouse marry. For Year 2, Liable Spouse incurs a tax liability, that, under Wisconsin law, is a liability incurred

during marriage but is not for the benefit of marriage or family. Non-Liable Spouse is not liable for this tax liability under Wisconsin law.

In Year 4, Liable Spouse and Non-Liable Spouse file a joint return for Year 3, reporting an overpayment of \$1,000. The overpayment resulted from income taxes withheld from Liable Spouse's and Non-Liable Spouse's wages during Year 3. Applying Rev. Rul. 80-7, the Service determines that \$750 of the overpayment is attributable to income taxes withheld from Liable Spouse's wages, and \$250 of the overpayment is attributable to income taxes withheld from Non-Liable Spouse's wages. Wisconsin community property laws are the same as in *Situation 2*.

*Situation 4, Wisconsin.* Same as *Situation 3*, except that under Wisconsin law, Liable Spouse's Year 2 tax liability is a liability for the benefit of marriage or family.

## LAW

Section 6402(a) of the Internal Revenue Code provides that, in the case of any overpayment, the Service may credit the amount of the overpayment, including interest, against any internal revenue tax liability on the part of the person who made the overpayment and shall refund the balance to the person.

Revenue Ruling 74-611, 1974-2 C.B. 399, holds that if a husband and wife file a joint return, each spouse has a separate interest in the jointly reported income and a separate interest in any overpayment. However, filing a joint return does not create a new property interest for the husband or the wife. *Id.*

Revenue Ruling 80-7, 1980-1 C.B. 296, holds that if a husband and wife file a joint return showing an overpayment, the Service may credit one spouse's interest in the overpayment against that spouse's separate tax liability. The amount of the spouse's interest in the overpayment is calculated by subtracting the spouse's share of the joint tax liability, determined under a separate tax formula, from the spouse's contribution towards the joint tax liability. Under the separate tax formula, a spouse's share of the joint tax liability is calculated as follows:

Revenue Ruling 85-70, 1985-1 C.B. 361, provides a two-step process to determine the amount of a joint overpayment that the Service may offset against one spouse's separate tax liability if the spouses are domiciled in a community property state. First, if the joint overpayment is from wages that are community property income, then each spouse is considered to be the recipient of one-half of the aggregated wages regardless of whether the spouses may have earned different amounts of wages (the one-half rule). Accordingly, each spouse has a one-half interest in the overpayment, and the Service may offset the liable spouse's one-half interest in the overpayment against the liable spouse's separate federal tax liability regardless of whether state law provides that creditors may reach community property to satisfy the separate debts of a spouse. *Id.* Rev. Rul. 85-70 does not specifically address what portion of each spouse's actual wages is treated as having been offset as a result of applying the one-half rule. Under the facts of Rev. Rul. 85-70, and specifically the assumed state laws, that analysis was not necessary. However, applying the second step of Rev. Rul. 85-70 in other cases may require a determination of the amount of each spouse's actual wages that were offset after applying the one-half rule. For that purpose, each spouse under the first step

of Rev. Rul. 85-70 is treated as receiving one half of the wages from each community property source (or, collectively, one-half of the aggregated wages) and as such being entitled to receive one-half of the income tax withheld from each community property source.

Second, Rev. Rul. 85-70 provides that state law may enable the Service to offset an additional portion of the joint overpayment from community property sources to satisfy a spouse's separate federal tax liability. This additional right of offset is available if state law provides that creditors may reach community property to satisfy the separate debts of a spouse. (The amount potentially available to be offset under the second step of Rev. Rul. 85-70 is the amount remaining after application of the first step of that revenue ruling.) However, if state law provides that community property may not be reached to satisfy the premarital or other separate debts of either spouse, then the Service may not offset any portion of the non-liable spouse's share of the overpayment from community property sources against the liable spouse's separate tax liability. *Id.*

*Five-step process to determine amount of joint overpayment that the Service may offset against separate federal tax liability of one spouse.*

A five-step process is required to determine the amount of a joint overpayment that the Service may, pursuant to section 6402(a), offset against the separate federal tax liability of one spouse.

The first step is to identify the underlying source of the overpayment. The Service looks to the tax payments made by the spouses, including income tax withholding and estimated tax payments and other credits, such as the earned income tax credit, that gave rise to the overpayment. If the earned income tax credit is a source of the overpayment, *see* Rev. Rul. 87-52, 1987-1 C.B. 347, for guidance.

The second step is to characterize the underlying source of the overpayment as either separate or community property. Because an overpayment will be characterized in the same manner as the source of the overpayment, an overpayment will be characterized as community property, separate property, or as part community property and part separate property, depending on the character of the source of the overpayment. If the overpayment is part community property and part separate property, the portion of the overpayment attributable to a separate property source must be subtracted from the remainder of the overpayment. The portion of the overpayment attributable to a separate property source is calculated as follows:

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Tax Payment From a Separate Property Source

Total Tax Payments

x Overpayment

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The third step is to offset the liable spouse's share of the overpayment from a community property source against the liable spouse's separate tax liability. Under Rev. Rul. 85-70, the Service may offset the liable spouse's 50-percent interest in the overpayment from a community property source to satisfy the liable spouse's separate tax liability.

The fourth step is to determine whether, under state law, the Service may reach the non-liable spouse's share of the overpayment from a community property source. *See* Rev. Rul. 85-70.

The fifth step is to determine whether the Service may, under state law, reach a portion of the overpayment from a separate property source of the liable spouse or the non-liable spouse.

#### ANALYSIS

*Apply the five-step process to each situation.*

(1) *Step 1.*

In *Situation 1, Situation 2, Situation 3, and Situation 4*, the overpayment is from income taxes withheld in Year 3 from Li-

able Spouse's and Non-Liable Spouse's wages.

(2) *Step 2.*

Arizona and Wisconsin law presume that all property acquired during marriage by either spouse or both spouses, including wages, is community property. In *Situation 1, Situation 2, Situation 3, and Situation 4*, the overpayment results from income tax withholding from Liable Spouse's and Non-Liable Spouse's wages. Because state law presumes that wages are community property, the entire overpayment in *Situation 1, Situation 2, Situation*

3, and *Situation 4* is assumed to be from a community property source.

(3) *Step 3.*

Under Arizona and Wisconsin law, each spouse has a present and equal interest in all community property. In *Situation 1*, *Situation 2*, *Situation 3*, and *Situation 4*, \$750 of the overpayment is from income tax withholding from Liable Spouse's wages, and \$250 of the overpayment is from income tax withholding from Non-Liable Spouse's Year 3 wages. Applying Rev. Rul. 85-70, the Service may offset \$375 of the income tax withholding attributable to Liable Spouse's wages and \$125 of the income tax withholding attributable to Non-Liable Spouse's wages. Therefore, in *Situation 1*, *Situation 2*, *Situation 3*, and *Situation 4*, the Service may offset \$500 of the overpayment against Liable Spouse's separate tax liability.

(4) *Step 4.*

Under Arizona and Wisconsin law, the amount of community property that a creditor may reach depends on the character of the debt.

In *Situation 1*, Liable Spouse's Year 1 tax liability is a separate debt under Arizona law. To satisfy a separate debt, Arizona law provides that a creditor may reach all community property that would have been Liable Spouse's separate property but for marriage. Under Arizona law, Liable Spouse's wages and income tax withholdings would have been Liable Spouse's separate property had Liable Spouse and Non-Liable Spouse not married. Therefore, a creditor may reach all of Liable Spouse's wages and income tax withholdings to satisfy Liable Spouse's separate debt. Applying Arizona law in Step 4, and in addition to the amount offset in Step 3, the Service may offset the remaining \$375 of the overpayment that is attributable to Liable Spouse's wages and income tax withholdings.

In *Situation 2*, Liable Spouse's Year 1 federal tax liability is a liability incurred before marriage that is attributable to action or inaction before marriage under Wisconsin law. In this situation, Wisconsin law provides that a creditor may reach all marital property that would have been Liable Spouse's individual property but for marriage. Under Wisconsin law, Liable Spouse's wages and income tax withholding would have been Liable Spouse's separate property had Liable

Spouse and Non-Liable Spouse not married. Therefore, a creditor may reach all of Liable Spouse's wages and income tax withholding to satisfy Liable Spouse's Year 1 tax liability. Applying Wisconsin law in Step 4, and in addition to the amount offset in Step 3, the Service may offset the remaining \$375 of the overpayment that is attributable to Liable Spouse's wages and income tax withholdings.

In *Situation 3*, Liable Spouse's Year 2 tax liability is a liability that was incurred during marriage but was not for the benefit of the marriage or the family under Wisconsin law. In this situation, Wisconsin law provides that a creditor may reach Liable Spouse's interest in marital property. However, because the debt was not for the benefit of the marriage or family, applying Wisconsin law in this Step 4, the Service may reach only Liable Spouse's individual property and interest in marital property, and therefore may not offset any amount of the overpayment in addition to the amount offset in Step 3, from a community property source. Accordingly, the additional amount the Service may offset under Step 4 is zero.

In *Situation 4*, Liable Spouse's Year 2 tax liability is a liability that was incurred during marriage and was for the benefit of the marriage or the family under Wisconsin law. In this situation, Wisconsin law provides that a creditor may reach all marital property. Accordingly, the Service may offset the remaining \$500 of the overpayment against Liable Spouse's Year 2 tax liability.

(5) *Step 5.*

Under both Arizona and Wisconsin law, a creditor may reach 100 percent of Liable Spouse's separate property to satisfy Liable Spouse's separate tax liability. A creditor may not, however, reach any of Non-Liable Spouse's separate property to satisfy Liable Spouse's separate tax liability. In *Situation 1*, *Situation 2*, *Situation 3*, and *Situation 4*, no part of the overpayment is from a separate property source. Accordingly, there is no separate property that the Service may offset against the Liable Spouse's separate tax liability.

## HOLDING

*Situation 1.* The Service may offset \$875 of the overpayment against Liable Spouse's separate Year 1 tax liability.

*Situation 2.* The Service may offset \$875 of the overpayment against Liable Spouse's separate Year 1 tax liability.

*Situation 3.* The Service may offset \$500 of the overpayment against Liable Spouse's separate Year 2 tax liability.

*Situation 4.* The Service may offset \$1,000 of the overpayment against Liable Spouse's separate Year 2 tax liability.

## EFFECT ON OTHER REVENUE RULINGS

Revenue Ruling 80-7 and Rev. Rul. 85-70 are amplified and clarified.

## DRAFTING INFORMATION

The principal author of this revenue ruling is Michael A. Skeen of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this revenue ruling, contact Michael A. Skeen at (202) 622-4910 (not a toll-free call).