

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

**Offsets under section 6402; California, Idaho, and Louisiana 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 California, Idaho, or Louisiana. California, Idaho, and Louisiana 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. 2004-72**

### **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 California, Idaho, or Louisiana?

This ruling addresses how offsets apply for taxpayers filing joint returns and domiciled in California, Idaho, or Louisiana. Because these states have similar community property laws, California, Idaho,

and Louisiana 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 Arizona or Wisconsin should refer to Rev. Rul. 2004-71; 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, California.* 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 California at all relevant times.

Except as otherwise provided by statute, California law provides that all property, either real or personal, that is acquired during marriage is community property, and each spouse has a 50 percent interest in the community property. See Cal. Fam. Code sections 760, 751 (2003). There is a rebuttable presumption under California law that all property acquired by a spouse during marriage is community property. See *In re Marriage of Haines*, 39 Cal. Rptr. 2d 673, 681 (1995).

California law defines separate property as all property owned by a spouse prior to marriage, and all property acquired by a spouse by gift, bequest, devise, or descent. See Cal. Fam. Code section 770(a)(1), (a)(2) (2003). In addition, California law provides that all rents, issues, and profits from separate property are separate property. See Cal. Fam. Code section 770(a)(3) (2003).

California law provides that a creditor may reach all of the community property to satisfy a debt incurred by a spouse before or during marriage. See Cal. Fam. Code section 910(a) (2003). A creditor may also reach all of the liable spouse's separate

property to satisfy a debt incurred by the liable spouse; however, a creditor may not reach any of the non-liable spouse's separate property. See Cal. Fam. Code section 913 (2003).

*Situation 2, Idaho.* 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 Idaho at all relevant times.

Idaho law defines separate property as all property owned by a spouse before marriage, and all property acquired by a spouse during marriage by gift, bequest, devise or descent, or property acquired with the proceeds of his or her separate property. See Idaho Code section 32-903 (2003). Idaho law defines community property as all other property acquired by either spouse during marriage. See Idaho Code section 32-906(1) (2003). Idaho law provides a rebuttable presumption that property acquired during marriage is community property, and the burden of proof is on the party asserting that the property is separate property. See *Worzala v. Worzala*, 913 P.2d 1178, 1182 (Idaho 1996).

Idaho law provides that income generated during marriage from any property, regardless of whether the property is separate or community property, is generally community property, unless: (1) the conveyance by which the property is acquired specifically identifies this property as the separate property of one spouse; or (2) both spouses agree in writing that the property, and any income related to this property, is the separate property of one spouse. See Idaho Code section 32-906(1) (2003).

Idaho law provides that a creditor may reach all of the community property; both real and personal, to satisfy a spouse's separate debt. *Bliss v. Bliss*, 898 P.2d 1081, 1084 (Idaho 1995). If the husband incurs a debt, a creditor may not reach the wife's separate property to satisfy this debt. See Idaho Code section 32-911 (2003). Further, if the wife incurs a debt before marriage, a creditor may not reach

the husband's separate property to satisfy this debt. See Idaho Code section 32-910 (2003).

*Situation 3, Louisiana.* 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 Louisiana at all relevant times, and Liable Spouse's tax liability is a separate obligation as defined by Louisiana law.

Louisiana law defines separate property as including property acquired by a spouse prior to marriage, property acquired with that spouse's separate property, property acquired by a spouse through inheritance or donation to that spouse individually, damages awarded to a spouse in connection with the management of that spouse's separate property, and property acquired by a spouse from a voluntary partition of the community during marriage. See La. Civ. Code Ann. art. 2341 (2003). Louisiana law defines community property as property acquired by a spouse during marriage that is not separate property. See La. Civ. Code Ann. art. 2338 (2003). Louisiana law provides a rebuttable presumption that all property in the possession of either spouse is community property. See La. Civ. Code Ann. art. 2340 (2003). Each spouse has a 50 percent interest in community property. See La. Civ. Code Ann. art. 2336 (2003).

Louisiana law provides that a creditor may reach all of the community property to satisfy separate and community obligations. See La. Civ. Code Ann. art. 2345 (2003). In addition, a creditor may reach all of the liable spouse's separate property to satisfy separate and community obligations. See *Id.*

Under Louisiana law, obligations incurred by a spouse are either community obligations or separate obligations. See La. Civ. Code Ann. art. 2359 (2003). A community obligation is defined as an obligation incurred during marriage for either the common interest of both spouses or for the interest of the other spouse. See

La. Civ. Code Ann. art. 2360 (2003). A separate obligation is defined as an obligation that was incurred before marriage, after marriage has terminated, or during marriage, though not for the benefit of the community. *See* La. Civ. Code Ann. art. 2363 (2003). Louisiana law provides a rebuttable presumption that all obligations incurred during marriage are community obligations. *See* La. Civ. Code Ann. art. 2361 (2003).

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:

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Spouse's Separate Tax	x	Joint Tax Liability Reported on Return
Total of Both Spouses' Separate Tax		

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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:

The third step is to offset the liable spouse's share of the joint 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*, and *Situation 3*, the overpayment is from income taxes withheld in Year 3 from Liable Spouse's and Non-Liable Spouse's wages.

### (2) Step 2.

California, Idaho, and Louisiana law presume that all property acquired during marriage by either spouse or both spouses, including wages, is community property. In *Situation 1*, *Situation 2*, and *Situation 3*, 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*, and *Situation 3* is assumed to be from a community property source.

### (3) Step 3.

Under California, Idaho, and Louisiana law, each spouse has a present and equal interest in all community property. In *Situation 1*, *Situation 2*, and *Situation 3*, the Service may offset Liable Spouse's \$500 share of the overpayment, which is from a community property source against Liable Spouse's separate tax liability.

### (4) Step 4.

In *Situation 1* and *Situation 2*, under California and Idaho law respectively, a creditor may reach all of the community property to satisfy a debt incurred by Liable Spouse, regardless of whether the debt was incurred before or after marriage. In *Situation 3*, under Louisiana law, a creditor may reach all of the community property to satisfy a debt, regardless of whether the debt is a separate or community debt. Accordingly, in *Situation 1*, *Situation 2*, and *Situation 3*, the Service may offset the remaining \$500 of the overpayment.

### (5) Step 5.

Under California, Idaho, and Louisiana law, a creditor may reach all 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*, and *Situation 3*, 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 \$1,000 of the overpayment against Liable Spouse's separate tax liability.

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

*Situation 3.* The Service may offset \$1,000 of the overpayment against Liable Spouse's separate tax liability.

## EFFECT ON OTHER REVENUE RULINGS

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

## DRAFTING INFORMATION

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