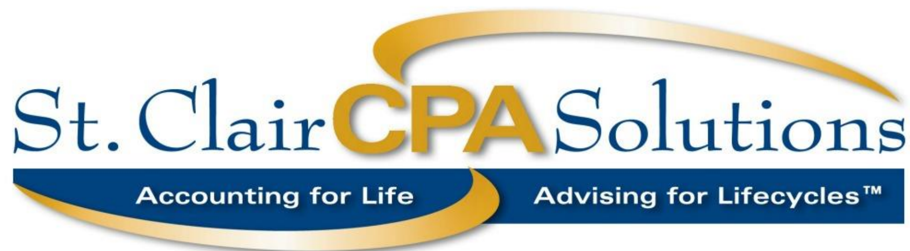

Wedding Bells: Tax Issues to Consider Before Tying the Knot

Fall 2017

If you or a loved one plan to get married, there are some important financial issues the happy couple should consider. Should you file jointly or separately in 2017? Will you be hit with the marriage penalty — or be lucky enough to qualify for the marriage bonus? Here's guidance to help answer these questions, along with a tax tip for newlywed property owners who need to combine their households. Marriage changes life in many ways. Here's how it may affect your tax situation.

Marital Status

Your marital status at year end determines your tax filing options for the entire year. If you are married on December 31, you'll have two federal income tax filing choices for 2017:

- File jointly with your spouse, or
- Opt for "married filing separate" status and then file separate returns based on your income and your deductions and credits.

Here are two reasons most married couples file jointly:

1. It's simpler. You only have to file one Form 1040, and you don't have to worry about figuring out which income, deduction and tax credit items belong to each spouse.

2. It's often cheaper. The married filing separate status makes you ineligible for some potentially valuable federal income tax breaks, such as the child care credit and certain higher education credits. Therefore, filing two separate returns may result in a bigger combined tax bill than filing one joint return.

Risks of Filing Jointly

Filing jointly isn't a sure-win for one big reason: For years that you file joint federal income tax returns, you're generally "jointly and severally liable" for any underpayments, interest and penalties caused by your spouse's deliberate misdeeds or unintentional errors and omissions.

Joint-and-several liability means the IRS can come after you for the entire bill if collecting from your spouse proves to be difficult or impossible. They can even come after you after you've divorced.

However, you can try to claim an exemption from the joint-and-several-liability rule under the so-called "innocent spouse" provisions. To successfully qualify as an innocent spouse, you must prove that you:

- Didn't know about your spouse's tax failings,
- Had no reason to know, and
- Didn't personally benefit.

If you file separately, you're certain to have no liability for your spouse's tax misdeeds or errors. So, if you have doubts about a new spouse's financial ethics, the best policy may be to file separately.

Penalty vs. Bonus

You've probably heard about the federal income tax "penalty" that happens when a married joint-filing couple owes more federal income tax than if they had remained single. The reason? At higher income levels, the tax rate brackets for joint filers aren't twice as wide as the rate brackets for singles.

For example, the 28% rate bracket for singles starts at $91,901 of taxable income for 2017. For married joint-filing couples, the 28% bracket starts at $153,101. If you and your spouse each have $90,000 of taxable income in 2017, for a total of $180,000, you'll pay a marriage penalty of $807. That's because $26,900 of your combined taxable income will fall into the 28% rate bracket ($180,000 – $153,100). If you stay single, none of your income will be taxed at more than 25%. The marriage penalty is usually a relatively modest amount; so, it's probably not a deal-breaker.

On the other hand, many married couples collect a federal income tax "bonus" from being married. If one spouse earns all or most of the income, it's likely that filing jointly will reduce your combined tax bill. For a high-income couple, the marriage bonus can amount to several thousand dollars a year.

Important note: The preceding explanation of the marriage penalty and bonus assumes that the current federal income tax rates will remain in place for 2017. However, rates and rate brackets could change depending on tax reforms that may be proposed and enacted before year end. Ask your tax advisor for the latest details on federal tax reform efforts.

Home Sales

When people get married, they often need to combine two separate households before or after the big day. If you and your fiancé both own homes that have appreciated substantially in value, you may owe capital gains tax.

However, there's a $250,000 gain exclusion for single taxpayers who sell real property that was their principle residence for at least two years during the five-year period ending on the sale date. The gain exclusion increases to $500,000 for married taxpayers who file jointly.

Suppose you and your fiancé both own homes. You could both sell your respective homes before or after you get married. Assuming you've both lived in your respective homes for two of the last five years, then you could both potentially claim the $250,000 gain exclusion. That's a combined federal-income-tax-free profit of up to $500,000.

Conversely, let's say you sell your home and move into your spouse's home. After you've both used that home as your principal residence for at least two years, you could sell it and claim the larger $500,000 joint-filer gain exclusion.

In other words, you could potentially exclude up to $250,000 of gain on the sale of your home. Then you could later claim a gain exclusion of up to $500,000 on the sale of the house that your spouse originally owned. With a little patience and some smart tax planning, you could potentially exclude a combined total gain of $750,000 on your home sales.

Questions?

Getting hitched may open up new tax risks — and some new tax planning opportunities. It pays to be well informed. Contact us for guidance on how getting married could change your tax situation in 2017.

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