PERSPECTIVE

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IRS Offers Up A Reason To Remain Unmarried?

By Robert W. Wood

If you are single, you file your taxes as "single." But if you are married, you can file either jointly or separately. Most married couples file jointly, since filing your taxes "married filing separately" is usually more expensive in the aggregate. But filing separate can be cleaner if you get divorced, or if your spouse has current, former or future tax problems.

But how you file if you are *married* is another topic. Here, I want to talk about the fact that you pay more taxes as a married couple than if you are two single tax filers. Most people call it the "marriage penalty." Think of the Internal Revenue Service as encouraging you to cohabit.

And the IRS just made it worse for married people and better for single people. If two unmarried people own a home, they get double the mortgage interest deduction available to a married couple. The 9th U.S. Circuit Court of Appeals started it with *Voss v. Commissioner*, 796 F.3d 1051 (9th Cir. 2015), *rev'g Sophy v. Commissioner,* 138 T.C. 204 (2012).

Now, the IRS has agreed, and has applied this rule nationwide! In AOD 2016-02, 2016-31 I.R.B. 193, called an IRS "Action on Decision," the IRS acquiesced in the 9th Circuit's decision. In *Voss*, Bruce Voss and Charles Sophy, a same-sex, unmarried, cohabiting couple, each deducted the interest on their big mortgage loan. Both of them were paying their half of the interest, but the question was whether their big loan was too big.

Normally, of course, you can write off your mortgage loan, up to a limit. The limit is $1 million of acquisition indebtedness, and $100,000 of home equity indebtedness. That makes the ceiling $1.1 million of debt. So you have a $2.2 million house debt that otherwise qualifies, you can only write off half of your interest — the amount relating to the first $1.1 million.

The question is how this rule applies for single and married people. The IRS said two people — married or not — face these limits together. But the 9th Circuit said two *unmarried* people could write off the interest on up to $2.2 million of debt. The 9th Circuit said the mortgage interest limitation applies per-taxpayer, not per-residence.

If the couple gets married, the maximum debt that could qualify for writing off the interest? Half that amount. Up until now, everyone seemed to *assume* that the $1.1 million loan limit was for a residence, regardless of whether a single person, married person, or several single people lived there. But in *Voss*, the couple took on the IRS. Voss and Sophy each filed a Tax Court petition, and the two cases were consolidated. They lost in Tax Court in 2012, and then went to the 9th Circuit.

Bear in mind that you *still* have to be careful with mortgage interest deductions. The easiest way to qualify is with purchase money debt, where you put down a down payment, and get a bank loan for the rest. But in California, some people do end up with a mortgage loan than is more than $1 million.

When that happens, they still have to make the interest payments, but only part will be tax deductible. And that makes the payments even more painful. In Tax Court, the couple argued that they were each paying and were each entitled to write off their large interest payments. Individually, they argued, they should both get up to the $1.1 million debt allowance. (That is $1 million of purchase debt, and up to $100,000 more in debt for equity loans for home improvements.)

The Tax Court examined the technical language in the tax code and thought the answer was pretty clear. The court held that the debt limit for their interest deductions applied on a per-residence basis. But in 2015, the 9th Circuit held that the $1.1 million limit on qualified debt is determined per-taxpayer, not per-residence.

The 9th Circuit thought the answer was clear, and was linked to the question of how *married* taxpayers were treated. The tax deduction for mortgage interest is contained in Section 163. In the case of married taxpayers who file separate tax returns, Section 163(h)(3) provides that the $1 million limit on qualified residence interest and $100,000 of home equity interest are reduced to $500,000 and $50,000.

The fact that there was a special rule cutting down the qualifying amount of debt *only for married people* filing their taxes separately, was telling. The 9th Circuit said that apart from that *specific* exception, married taxpayers filing separately should be treated just like married taxpayers under Section 163. In short, two married taxpayers who file their taxes separately are subject to the same limits as married taxpayers or a single taxpayer.

The 9th Circuit said that means the limitation on qualifying debt (for purposes of interest deductions) applies per-taxpayer, not per-residence. If you have a big mortgage, this is worth knowing. It seems unlikely that many people will hold off getting married for this reason.

It also seems unlikely that people will get divorced so they can each take advantage of this deductible interest rule. But who knows. If nothing else, this may be another reminder that getting married involves taxes. And although there have been strides in some areas like same sex marriage, there can be tax downsides of marriage.

Presently, couples who are legally married cannot file taxes as unmarried taxpayers. Any couple that is married under state law, same-sex or otherwise, will only be permitted to file married filing jointly or married filing separately. And remember, whether you are new to marriage or have decades under your belt, it pays to think about your tax filing status.

There is a strong knee-jerk "file jointly" reaction, with a reported 95 percent of married couples filing that way. Many tax return preparers *automaticall*y do it that way and don't ask. Yet there is increasing evidence that filing jointly — at least without careful thought — can be shortsighted. Run the numbers and decide what is best on your facts.

Your marital status is determined on the last day of the year for the entire year. If your spouse died and you did not remarry during the year, you usually can still file a joint return for that year. But with that exception, to be eligible to file a married filing joint return, you must be married on December 31. But *eligible* doesn't mean you *have* to.

If you are legally divorced you should file single. But if you are still married on December 31 and not legally separated, you'll need to file married (presumably filing separate), not single. If more than one filing status applies to you, you can pick the one resulting in the lowest overall tax.

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