PERSPECTIVE

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Joint Tax Returns May Land You *And* Your Spouse In The Joint

By Robert W. Wood

In one recent criminal tax case, a man and woman filing their taxes jointly got three years in prison — each. We'll come back to that.

IRS statistics show that some 95 percent of all married couples file joint income tax returns. Joint tax returns usually save some money over the total taxes paid by a married couple who file two separate returns. And since two non-married people would pay less too, tax advisors say there is a marriage *penalty*.

But the (usually small) tax savings from joint filing can be more than offset by some big potential liabilities. For one, many people don't know that by filing jointly, each spouse is 100 percent liable for all taxes due. That is so even if the other spouse did not earn any income, and didn't know what his or her spouse was doing.

So it can lead to some tense times and bitter fights when the IRS comes calling. What's more, both spouses are 100 percent liable if the tax return under-reports income or contains other errors. If your spouse has big secrets, and the joint tax return you filed omits millions, both spouses are liable. Against that background, what about IRS *criminal* liability?

The stakes can be even higher then. And although both spouses can be held liable for understatements, etc., the IRS and prosecutors usually come after one spouse much more than the other. Sometimes they prosecute only the one that seems to be the real wrongdoer. But not always, as the case of a Brentwood, Tennessee doctor and his wife demonstrates.

Dr. Jeff McCoy Jr., 70, and Andra McCoy, 68 were *each* sentenced to serve 36 months in prison for conspiring to defraud the IRS. Yes, each. The McCoys filed 2003 through 2007 income tax returns with the IRS on which they claimed fake income tax withholding amounts, and sought approximately $2,620,208 in fraudulent tax refunds. They submitted false documents to the IRS, and placed their assets in the names of nominees and in nominee bank accounts.

They ended up pleading guilty. In addition to three years in prison each, Jeff and Andra McCoy were also ordered to each serve three years of supervised release and to pay $913,595 in restitution to the IRS. Although the tax dollars here were significant, arguably the most egregious facts were the McCoys' conduct during the IRS audit.

That series of actions (lying, creating false documents, hiding their ownership, etc.) may well have spurred prosecutors to push harder for a conviction and for jail time. Without question, false statements to auditors are a huge mistake. Clearly, creating false documents is a terrible idea too. In fact, in many ways, conduct during the audit itself can be pivotal.

This is one reason to hire professionals to handle it. Another big issue in the case was the use of entities, and kind of shell game, using entities, nominees, etc. to try to make it hard for the IRS to figure out who owned — and who earned — what. In short, don't try to emulate the example of these taxpayers. Of course, whether this pair was filing jointly or separately, they probably would have been in hot water!

For more *conscientious* couples, there still can be worries. You may have heard that if you get into hot water over something your spouse did you can claim 'innocent spouse' treatment. But it is much harder than most people realize. Getting innocent spouse relief is often fraught with problems, as there are numerous hurdles and limitations.

You can avoid these issues entirely by filing taxes 'married filing separate.' The issue is biggest for couples with sizable assets, especially where one or both face business or tax risks. Plus, there is always that looming "you never told me" kind of problem. If one spouse has current or past legal, tax or credit problems, separate filings can save you headaches.

That's true with couples who have separate property too. If one spouse comes into the marriage with many assets and with a prenuptial agreement, separate tax filings help keep things separate. If divorce is on the horizon, that is another good reason to file separately.

There are actually five filing choices: Single, Married Filing Jointly, Married Filing Separately, Head of Household and Qualifying Widow(er) with Dependent Child. Your marital status on the last day of the year determines your marital status for the entire year. To be eligible to file a married filing joint return, you must be married on December 31. If you are legally separated under state law you can file single. Of course, if you are legally divorced you can also 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, you can pick the one giving you the lowest tax. But sometimes even if you would pay less that way, it is worth considering filing separately. Run the numbers both ways and consider if joint or separate returns are better for you. Even if you'll pay less by filing jointly, weigh the pros and cons. It can be worthwhile to keep returns separate, especially if one spouse has past credit, tax or legal problems or any of these problems seem likely in the future.

Separate filings help keep assets from being co-mingled too, which can make divorce less consequential. Avoid the automatic joint filing reaction, and think through what is best for you. And remember, all tax returns must be signed under penalties of perjury.

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