WHEN AN EXCHANGE OF VOWS IS FOLLOWED BY SEPARATE OWNERSHIP OF SHARES SHOULD EITHER SPOUSE FEEL G.I.L.T.I.?

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Code §6013
Form 8992
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Poe v. Seaborn, 282 U.S. 101
REG-104464-18
Revenue Act of 1948
Rite Aid Corp., 255 F.3d 1357
Treas. Reg. §1.951A-1
Treas. Reg. §1.1502-51
Treas. Reg. §1.6013-4(b)
Treas. Reg. S1.6038-5
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INTRODUCTION

> "Get thee a good husband,
> and use him as he uses thee."
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> – *All's Well That Ends Well*, Act 1, Scene 1

> "Marriage is a matter of more worth
> Than to be dealt in by attorneyship."
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> – *Henry VI*, Part I, Act 5, Scene 5

Today's cross border tax planners are expected to know all there is about various provisions of Subchapter N of the Internal Revenue Code. That is home to several provisions of U.S. tax law that affect taxpayers with foreign income. Examples include (i) the source of income, (ii) the imposition of U.S. tax on nonresident, non-citizen individuals, (iii) the taxation of foreign corporations, (iv) the foreign tax credit, (v) the foreign earned income exclusion, (vi) Subpart F income, (vii) G.I.L.T.I., (viii) the transition tax, (ix) currency transactions, and (x) international boycott income. Cross border tax planners are not expected to know more mundane provisions of tax law such as the rules that apply to married persons filing a joint tax return, with the possible exception of elections that apply when one of the spouses is neither a citizen nor a resident of the U.S.

Yet, as the I.R.S. rolls out regulations on all the provisions in Subchapter N that have been affected by the Tax Cuts & Jobs Act of 2017, strangely enough the highly sophisticated provisions of Subchapter N can be affected by the highly mundane provisions regarding married individuals electing to file joint tax returns with a U.S. spouse.

This article addresses a recent hiccup in the tax law that is brought about under the G.I.L.T.I. provisions of U.S. tax law that focus computations in a top-down way. What happens when one spouse separately owns C.F.C.'s with losses and the other spouse separately owns C.F.C.'s with positive earnings in a fact pattern where none of the C.F.C.'s generates Subpart F income? If a joint tax return is filed, are the tested losses of companies owned by one spouse available to offset tested income of companies owned by the other spouse? The answer should be simple, but is it?

JOINT TAX RETURNS

In a report to Congress prepared by the U.S. Treasury Department in 1998[1] incident to adoption of Section 401 of the Taxpayer Bill of Rights,[2] requiring the Treasury Department to conduct a study of issues relating to joint income tax returns, the Treasury Department focused on the history of the joint tax return filed by married couples.

> In 1918, married taxpayers were allowed to file joint returns. This earliest form of joint filing permitted spouses to offset deductions and losses against each other's income. There was only one tax rate schedule for taxpayers, however, regardless of whether they filed jointly or separately. If both spouses earned income and did not have offsetting deductions or losses, the result of filing jointly would have been an increase in total tax because of the single tax rate schedule and that schedule's progressivity. * * *
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> In 1938, Congress enacted the predecessor of I.R.C. § 6013(d), which introduced explicit statutory joint and several liability for joint returns. As explained in the legislative history, the provision was enacted to preserve the administrative ease of joint filing for taxpayers and the Government * * *
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> * * *
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> In *Poe v. Seaborn*, 282 U.S. 101 (1930), the Supreme Court held that a husband and wife in a community property state were entitled to file separate returns, each treating one-half of the couple's community income as his or her respective income for Federal income tax purposes. Because of progressive rate structures, the immediate effect of *Poe v. Seaborn* was that many married couples with only one income earner who resided in community property states could pay significantly less tax than their counterparts in common law states by choosing to report their income on separate returns. * * *

The current provision, Code §6013, was added by the Revenue Act of 1948, with the objective of allowing married taxpayers in States without community property laws to obtain similar treatment as those in States that do, *i.e.*, split income equally between two individuals, frequently offering a tax rate benefit.[3] By virtue of checking "married filing jointly" two taxpayers report all their income and deductions together to determine taxable income and pay tax due.

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1 Report to the Congress on Joint Liability and Innocent Spouse Issues, pp. 6-7.

2 2, Pub. L. No. 104-168, 110 Stat. 1453 (July 30, 1996).

3 In consequence of *Poe v. Seaborn*, 282 U.S. 101, *supra*, taxpayers in community property states who do not file joint returns are generally liable for the tax on half of community income regardless of which spouse generated the income.

APPLICATION TO G.I.L.T.I.

The question posed is whether the system adopted to split income of a married couple works well in connection with the computation of G.I.L.T.I. where one spouse owns C.F.C.'s with positive tested income and the other spouse owns C.F.C.'s with tested losses.

"The irony is that uncertainty arises here due to Congress's largesse in two perhaps competing respects. . ."

The irony is that uncertainty arises here due to Congress's largesse in two, perhaps competing respects — on the one hand, the policy *vis-à-vis* married taxpayers to allow pluses of one to offset minuses of the other; and the architectural feature of the G.I.L.T.I. system on the other hand, allowing U.S. Shareholders in multiple C.F.C.'s, to use negative results of one C.F.C. to offset positive results of another. As noted by one senator in an April 2000 Senate floor discussion of a Republican-backed bill to eliminate certain marriage penalties in the Code, "the ironic thing about the marriage penalty is that it was actually borne out of fairness."[4]

Example

Assume Wife ("W") and Husband ("H"), each a U.S. citizen, are newlyweds and each owns a European business.[5] The property regime applicable to H and W is one of separate property. W incorporated her business several years ago as a *société anonyme* ("S.A") under the laws of France. H formed his business as a German *Gesellschaft mit beschränkter Haftung* ("GmbH") prior to 2017. For illustration, assume that S.A.'s business in 2019 has been profitable, netting $100, while GmbH's business has netted losses of $100.

Under Code §951A global intangible low-taxed income provisions ("G.I.L.T.I."), S.A.'s earnings gives rise to $100 tested income for W, and $100 of G.I.L.T.I. each year, assuming no allocable deductions. G.I.L.T.I. applies to tax years beginning after 2017 to a U.S. shareholder owning at least 10% of controlled foreign corporations, by vote or value ("U.S. Shareholder"), in which U.S. Shareholders collectively own more than 50% by vote or value, thereby making the foreign corporation a controlled foreign corporation ("C.F.C."). In 2019 W, as U.S. Shareholder of S.A., a C.F.C., reports $100 of net tested income which results in $100 of G.I.L.T.I. taxable at the highest marginal rate.[6] At the same time, the GmbH owned by H is a C.F.C. In 2019, it generates a net tested loss of $100, and zero G.I.L.T.I. income to H. The

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4 In Senate floor discussion of Republican marriage tax penalty relief in 2000 referred to as the Marriage Tax Penalty Relief Reconciliation Act of 2000, ultimately passed by a slim Republican majority in both houses – who lost control of the Senate that year – but vetoed by President Clinton before leaving office, Arkansas Senator Blanche Lincoln (D) explained that the Republican plan, in her view, addressed only 3 out of 65 marriage penalties in the Code.

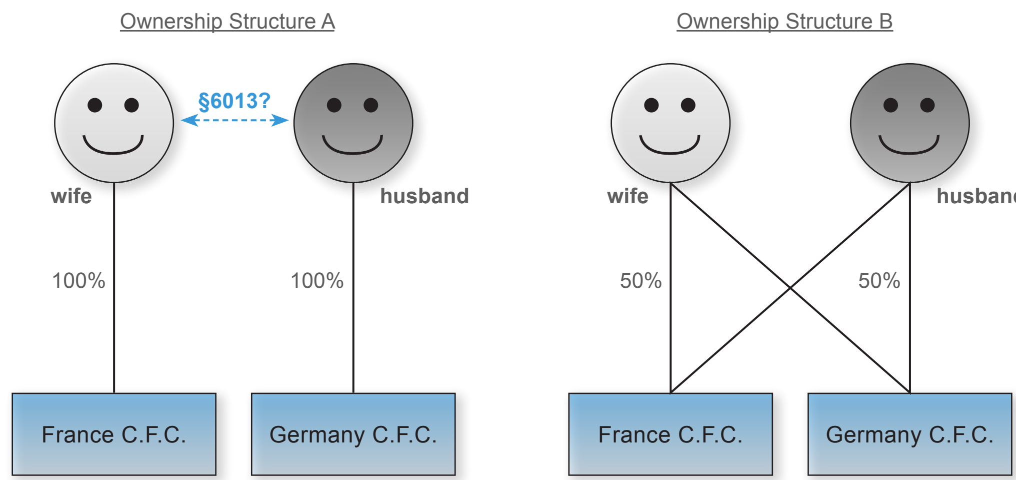
5 Consistent with Treas. Reg. §301.7701-18 wherein the I.R.S. reflected the Supreme Court's decisions in *Obergefell v. Hodges*, 135 S. Ct. 2584 (2015) and *U.S. v. Windsor,* 570 U.S. 12 (2013), the terms spouse, husband, and wife since 2016 refer to lawfully married individuals with a gender neutral signification.

6 If W lives in New York State, 5% of the total G.I.L.T.I. (or in the example above, $5) may also be taxable at the State level at maximal rates for married couples filing jointly of up to 8.82% (declining to 6.57% over a few years). N.Y.C.'s highest tax bracket applicable to married filing jointly returns is 3.876%. Confusingly, N.Y.C. has not updated its rules post 2018, and follows prior N.Y.S. rules which included 100% of G.I.L.T.I. in taxpayer income after any Code §250 deduction.

tested loss cannot be carried forward to any future year of H. The tested loss is not a recognized loss for H in that it does not reduce other income. That being the case, will the filing of a joint income tax return produce a benefit for the couple?

The fact pattern is illustrated in Ownership Structure A of Figure 1, that appears below. The alternative Ownership Structure B reflects actual co-ownership of the two companies or the application of a community property regime between the spouses; under a community property regime, Structure A would potentially be treated as Structure B if the C.F.C.'s were acquired by both spouses after the marriage or a decision was made to convert the C.F.C.'s to community property.[7]

Fig. 1: The Newlyweds' C.F.C.'s



While on H and W's facts, Code §6013 ideally should treat Structure A the same as Structure B, there is no specific guidance on this topic and the conclusion certainly is not addressed in regulations issued by the I.R.S. under the G.I.L.T.I. regime.

Courses of Action Available to H and W:

Faced with this issue, what alternatives are available to support netting H's tested loss against W's tested income for purposes of computing the G.I.L.T.I. tax, assuming that community property laws are not available?

There are several possible courses of action available to H and W:

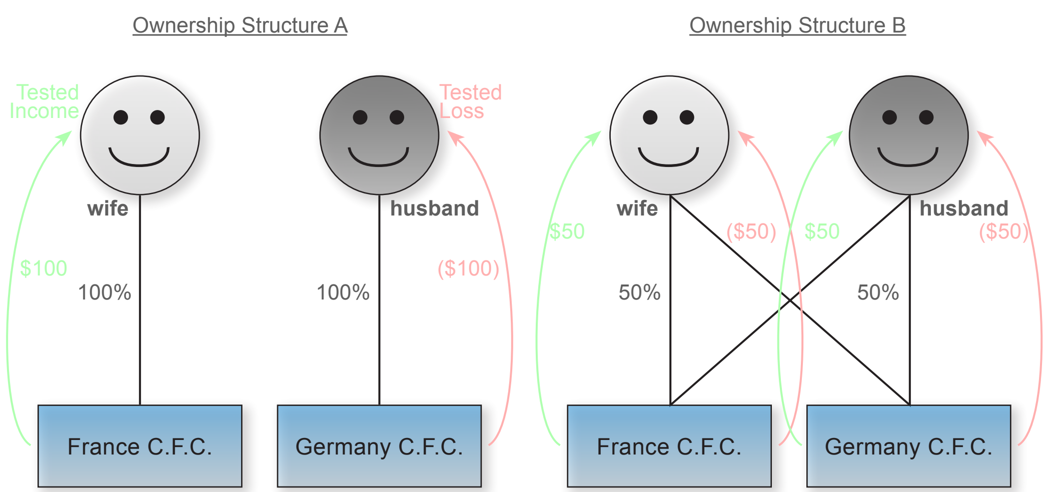
1. The first course of action is to do nothing, hoping that the I.R.S. will provide guidance based on its grant of authority to provide appropriate rules regarding G.I.L.T.I. Alternatively, H and W may do nothing, hoping for a solution as part of a technical corrections bill to the Tax Cuts & Jobs Act, if ever adopted. An issue with this approach is that no certainty exists that either the I.R.S. or Congress will act before the taxpayer's 2019 tax return is examined. If this course of action is taken, the computation is illustrated in Fig. 2, Ownership Structure A, below.

[7] See Pub. 555, *Community Property*.

2. The second course of action is to do nothing based on the legislative history at the time U.S. tax law was amended to provide for joint tax returns with enhanced brackets. As explained above, the purpose was to eliminate disparity in tax treatment between married couples resident in common law states and married couples resident in community property states. An issue with this approach is that case law involving married couples wishing to be treated as a single taxpayer does not reach consistent results. Some courts reach favorable conclusions and others reach unfavorable conclusions. How one identifies whether the favorable or unfavorable cases will control is somewhat of a crapshoot. In any event, it should be remembered that the I.R.S. argued for the unfavorable approach in all the cases. The cases are discussed below in this article. If this course of action is taken, the computation is illustrated in Fig. 2, Ownership Structure A, below.

3. The third course of action is for H and W to gift 50% interests in each of GmbH and S.A., respectively to the other spouse, effectively replicating community property rules. Several issues with this approach are technical and practical. Regarding the technical issues, confirmation must be obtained from both U.S. and European tax advisers that the simultaneous gifts can be effected at no tax cost, taking into account both income and inheritance taxes. In the U.S., cross-gifts might resemble a taxable exchange, especially if cash balancing is involved to eliminate differences in value, though there do not seem to be cases applying this approach to married couples. Regarding practical problems, H and W may wish to retain ownership separately in the event of a termination of the marriage. This may suggest that netting tested income and losses between the spouses should not be permitted because the married couple are not acting as a "single unit" as to all their property. If this course of action is taken, the computation is illustrated in Fig. 2, Ownership Structure B, below.

Fig. 2: Why are "G.I.L.T.I." Couples Punished?



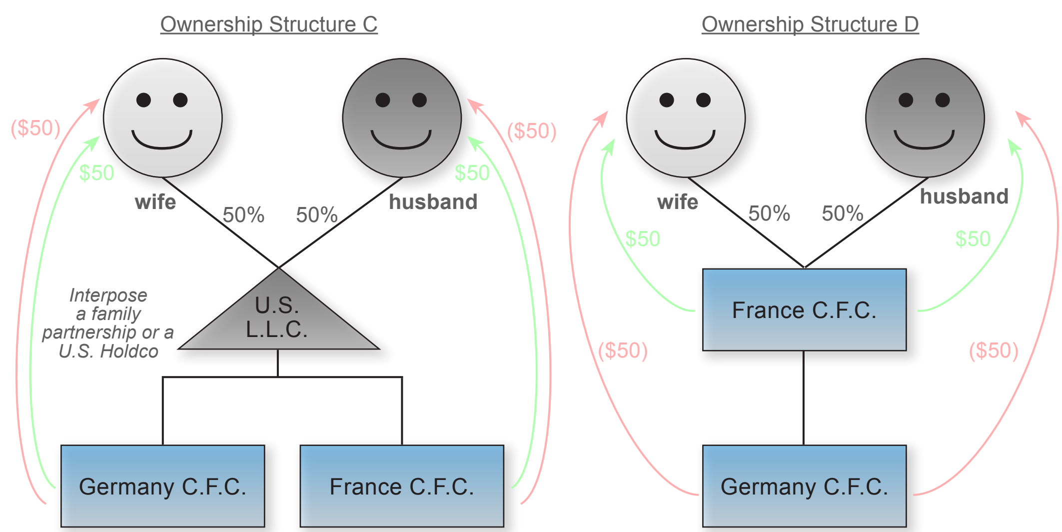
For W, $100 G.I.L.T.I. income on return:	
Tested Income	$100
Tested Loss	($0)
Net Tested Income / G.I.L.T.I. inclusion	$100

For each of W and H:	
Tested Income	$50
Tested Loss	($50)
Net Tested Income / G.I.L.T.I. inclusion on Joint Return	$0

4. The fourth course of action is for H and W to transfer 100% of the interests in each of GmbH and S.A. to a joint holding vehicle, possibly one that is tax transparent for U.S. tax purposes as well as European law purposes. A simple general partnership may be appropriate because of the absence of legal personality and the ease with which it can be disbanded. These features may allow the entity to be transparent in Europe as well as the U.S. Another alternative is an S-corporation, which is tax transparent or a C-corporation that is not tax transparent. S-corporations provide favorable tax benefits in connection with ongoing income and losses. However, S-corporation transfers of assets to shareholders are taxable events in the U.S. C-corporations are not tax transparent, but the tax rates under existing U.S. tax law are low in general – 21% – and even lower for G.I.L.T.I. inclusions, once the 50% deduction is taken into account. If this course of action is taken, and the U.S. L.L.C. is taxed as a partnership, the G.I.L.T.I. computation is illustrated in Fig. 3, Ownership Structure C, below.

5. The fifth course of action is for one spouse to contribute the shares to the corporation owned by the other spouse. In return, shares of the corporation effecting the acquisition would be the only consideration received by the transferor spouse. This course of is attractive only if the transaction can be effected in a tax-free way in the U.S. and in Europe. In the U.S., an outbound transfer may have issues under Code §367(a) but may be treated as a foreign-to-foreign reorganization tax-free under Code§ 368(a)(1)(D), covered by Code § 367(b). To be treated as a transfer of assets treated as a tax-free "D" reorganization, it would also be necessary for Germany C.F.C. to be checked pursuant to the plan to be treated as an entity disregarded as separate from France C.F.C. Advice of European tax advisers would be required as to European taxes, both income and transactional (such as stamp duties). Again, this structure will be problematic and would need to be undone in the event of a termination of the marriage. If this course of action is taken, the computation is illustrated in Fig. 3, Ownership Structure D.

Fig. 3: Two Additional Self-Help Options (Fourth & Fifth Course of Action for H and W)



Additional Tax Considerations

If an election is made to treat U.S. L.L.C. as a C-corporation, U.S. HoldCo can claim a Code §250 deduction reducing the corporation's G.I.L.T.I. by 50%, and is entitled to claim Code §960(d) 80% foreign tax credits.[8] If Structure B, C (assuming the L.L.C. is taxed as a partnership for U.S. purposes) or D are selected, the couple can consider making a Code §962 election to defer tax at their highest marginal tax rate until an actual distribution, or a high-tax election if the foreign effective tax rate for a C.F.C. or its tested unit is greater than 18.9% in any particular year.

WHAT ARE THE STEPS OF THE G.I.L.T.I. COMPUTATION IN A JOINT RETURN CONTEXT?

Determining the G.I.L.T.I. inclusion involves a C.F.C.-level and U.S. Shareholder-level calculation.

C.F.C.-level Calculation

Once all the U.S. Shareholders of each C.F.C. are identified, G.I.L.T.I. requires each to determine the following for each owned C.F.C.:

1. Gross income applying U.S. tax principles
2. Gross tested income, derived by removing Subpart F, U.S. source income, related-party dividends, and certain oil and gas extraction income from gross income
3. Net tested income, derived by offsetting all allocable and apportionable deductions; C.F.C.'s with a net positive amount after this step (tested income) are referred to as a "tested income C.F.C." and those with a net negative amount (tested loss) are referred to as a "tested loss C.F.C."

"Determining the G.I.L.T.I. inclusion involves a C.F.C.-level and U.S. Shareholder-level calculation."

Shareholder-level Calculation

The next steps are all determined at the U.S. Shareholder level:

1. Aggregate of shareholder's *pro rata* share of tested income from all tested income C.F.C.'s, over aggregate tested loss from all tested loss C.F.C.'s ("net C.F.C. tested income" or "loss")
2. Net deemed tangible income return is computed as (i) 10% of *pro rata* share of Q.B.A.I. from all tested income C.F.C.'s, less (ii) specified interest expense ("net D.T.I.R.")
3. Deduct net D.T.I.R. from net C.F.C. tested income. The result is G.I.L.T.I.

Joint Tax Returns — How Are the Joint Calculations Harmonized?

Treas. Reg. §1.6013-4(b) provides in relevant part, that where a couple files a joint return all items are to be aggregated as follows:

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8 The S election may be made for Federal and N.Y.S. purposes, but not N.Y.C. In addition, under Notice 2020-69, S corporations may irrevocably elect to be treated as the U.S. Shareholder recognizing G.I.L.T.I. income for purposes of adjusting the accumulated adjustments account, which makes sense if they have C period accumulated earnings and profits.

> If a joint return is made, the gross income and adjusted gross income of husband and wife on the joint return are computed in an aggregate amount and the deductions allowed and the taxable income are likewise computed on an aggregate basis. Deductions limited to a percentage of the adjusted gross income, such as the deduction for charitable, etc., contributions and gifts, under section 170, will be allowed with reference to such aggregate adjusted gross income. A similar rule is applied in the case of the limitation of section 1211(b) on the allowance of losses resulting from the sale or exchange of capital assets (see §1.1211–1). Although there are two taxpayers on a joint return, there is only one taxable income.

Based on legislative intent of Code §6013 to treat joint filers similar to married couples in community property states, there is a view that simply by the act of filing the joint return Ownership Structure A is recast as Structure B as shown in Fig. 2, previously.

As discussed below, case law does not uniformly apply aggregation principles to married couples filing joint tax returns, but frequently defers to the legislative purpose underlying a specific Code provision. It is unclear what legislative purpose of Code §958 would defeat aggregation of tested income and loss under Code §6013, however outside of the joint return context only subsection (b) of Code §958 applies attribution principles. Courts generally require attribution to be specifically permitted or required by a statute, rather than inferred from the context.[9] In addition, the filing of a joint return does not by itself transmute separate property into marital.[10] Assumptions about Code §6013's legislative purpose notwithstanding, even for couples actually residing in a community property jurisdiction, there remains electivity to treat specific property as separate property. If a harmonizing provision or cross-reference were enacted under Treas. Reg. §1.951A-1(c) or Treas. Reg. §1.6014-4(b), one assumes that it would provide mechanics similar to the following:

- First, the spouses' *pro rata* shares of tested income and tested loss from all C.F.C.'s are aggregated, as if the couple were a single Code §958(a) U.S. Shareholder (step 1 of shareholder-level calculation).
- Next, the couple's *pro rata* shares of Q.B.A.I. and interest expense from all C.F.C.'s are also aggregated, once again treating both spouses as a single Code §958(a) U.S. Shareholder (step 2).
- Finally, G.I.L.T.I. is determined on an aggregate basis and the final result is divided by two.

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9 On occasion, the Tax Court has even refused to apply statutorily-required attribution, as in the case of the former foreign personal holding company provisions under Code §554 at issue in *Nellie Miller v. Commr.*, 43 T.C. 760 (1965), *nonacq*., 1966-1 C.B. 4, where the Court refused to attribute stock owned by a nonresident alien family member to a related U.S. family member despite the statute's plain language.

10 *Holston v. Holston*, 128 So. 3d 736 (Ala. Civ. App. 2013), at 744, citing Hunt v. Hunt, 389 S.W. 3d at 761-62. The consequence in H and W's case is that the couple's C.F.C.'s might default to separate property treatment under state law, even if residing in a community property jurisdiction where no election was made to treat the foreign legal entities as community property.

Nevertheless, Treas. Reg. §1.6014-4(b) only refers to items of income and deduction which includes G.I.L.T.I., but not items such as tested income and loss which do not show up anywhere on the tax return and arguably are tied to each spouse's separate interest in their respective C.F.C. Thus, if H and W were to proceed under the second course of action above (do nothing based on Code §6013's legislative history), assumptions are required to be made along the way.

Because paragraph (4) of Treas. Reg. §1.951A-1(c) in the G.I.L.T.I. rules contains an explicit cross-reference to the special consolidated G.I.L.T.I. mechanics of Treas. Reg. §1.1502-51, while there is no cross-reference to Treas. Reg. §1.6014-4(b) or joint tax returns, nor any statement that either attributive ownership under Code §318 or some kind of implicit aggregation principle under Code §6013 is relevant for married couples who own interests in C.F.C.'s and file joint returns, H and W are left bearing the risk if the I.R.S. should later disagree.

In short, a judgment call seems to be required that Code §958(a) should be applied in deference to a presumed aggregation principle in Code §6013. Based on the Instructions to Form 8992, *U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI)*, which indicate only that each Code §958(a) U.S. Shareholder should file a separate form, it appears the couple must rely on presumptions about the legislative intent of Code §6013 overriding separate ownership under Code §958(a) or imposing attribution despite the separate legal ownership.

In other situations where a different approach is mandated under G.I.L.T.I. or the international tax provisions, the I.R.S. has provided specific rules. For example, the I.R.S. enacted Treas. Reg. §1.1502-51 to modify the U.S. Shareholder-level G.I.L.T.I. calculation in the case of U.S. consolidated subsidiaries that are members of a group — rules which require additional concepts not otherwise needed for an individual's G.I.L.T.I. computation, and unique concepts such as the "G.I.L.T.I. Allocation Ratio."[11] Moreover, joint tax returns are distinguishable from consolidated groups because as at least one court has specifically noted, couples are not treated as a single taxpayer for all purposes unlike consolidated groups.[12] Consolidated groups require additional complex rules pertaining to basis and E&P adjustments, which are irrelevant for a married couple, meaning that H and W would be hard-pressed to concoct some kind of rule by analogy here.

In addition, in one other context in the international tax rules the I.R.S. specifically included a rule addressing married couples filing a joint tax return. In particular, in August 2020 and concurrently with issuance of Code §163(j) final regulations[13] the

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11 As the I.R.S. explained in the Preamble to the 2019 final G.I.L.T.I. regulations, the purpose of the special rules for consolidated U.S. affiliates is to ensure single-entity treatment at the level of the group, while preserving the location of tested income within the group for purposes of basis and E&P adjustments. The Instructions to Form 8992 provide that each affiliate preparing a Form 8992 must indicate all the relevant C.F.C's in Schedule A including C.F.C.'s from which the U.S. affiliate is allocated a portion of the consolidated tested loss, in addition to its own C.F.C.'s.

12 *J&S Carburetor Co. v. Commr.,* 93 T.C. 166 (1989) ("Moreover, our decision in *McClamma* [76 T.C. 754 (1981),] was premised on our conclusion in *Barron v. Commr.,* 71 T.C. 1028 (1978) that a husband and wife filing joint returns are to be treated as separate taxpayers rather than as a single taxpayer entity. Here it is appropriate to treat the affiliated group as a single taxpaying entity.")

13 T.D. 9905.

I.R.S. issued a Notice of Proposed Rulemaking (REG-106089-18) relating to application of Code §163(j) and Treas. Reg. §1.163(j)-7 to C.F.C.'s, which applies for purposes of determining how much interest expense should be taken into account as an offset each C.F.C.'s tested income ("Notice"). The Notice is relevant when the U.S. Shareholder is a single taxpayer, a married couple, or a domestic consolidated group. Under the Notice of Proposed Rulemaking, the I.R.S. would explicitly permit married couples filing a joint tax return to determine their Code §163(j) limitation on a joint basis for all commonly owned C.F.C.'s. The benefit of this elective relief is to reduce compliance costs of computing multiple separate Code §163(j) limitations when there are many C.F.C.'s owned in common.[14] Under the proposed regulation, "related United States shareholders" is defined to include "members of a consolidated group and individuals described in [Code §]318(a)(1)(A)(i) who file a joint tax return are treated as a single person."

In the context of our G.I.L.T.I. issue in H and W's context the Notice is relevant in two respects. First, the approach taken in the Notice may reflect an implicit I.R.S.'s view that married taxpayers filing joint returns are already conducting G.I.L.T.I. computations on a joint basis. However, the Notice also demonstrates that when the I.R.S. means for couples to be treated as a single person, it explicitly provides for that result (though in this case relief is elective rather than mandatory).

"Under the Notice of Proposed Rulemaking, the I.R.S. would explicitly permit married couples filing a joint tax return to determine their Code §163(j) limitation on a joint basis for all commonly owned C.F.C.'s."

As noted above, in the case of H and W even under community property rules, barring any special agreement, H and W's respective interests in their C.F.C.'s would likely be treated as separate property where acquired prior the marriage. Therefore, if the I.R.S. considers rules under either Treas. Reg. §1.6014-4(b) or Treas. Reg. §1.951A-1 (or elsewhere), to provide harmonized spousal G.I.L.T.I. mechanics, the rules should leave room for electivity. It would also be helpful, if the I.R.S. could update the Instructions to Form 8992 to provide that, similar to consolidated U.S. subsidiaries, married couples filing a joint tax return should attach two separate Forms 8992, and report their respective halves of the above computation, with respective G.I.L.T.I. amounts from Part II, line 5 aggregated as a single amount on Form 1040.

Under Rev. Proc. 2002-69, taxpayers living in a community property state may decide whether a limited liability company owned by either spouse is treated as a disregarded entity or as a partnership for U.S. Federal income tax purposes. Thus, should the I.R.S. issue guidance under Code §§951A and 6013 to address H and W's issue, such relief could be elective like the revenue procedure.

INCONSISTENT CASE LAW ON SINGLE UNIT OR AGGREGATE TREATMENT OF MARRIED COUPLE

Part of the difficulty for H and W relates to the fact that — under a profusion of precedents applicable to different contexts and Code provisions — there is no failsafe method for determining when married spouses filing jointly are required to aggregate their computations, and when to perform them separately. This state of affairs is markedly different both from the rules applicable to partnerships, which generally defer to the legislative policy of the underlying tax rule in question, and from the rules for consolidated returns which are supposed to reach a single-entity result. The following cases and rules are instructive, insofar as they reflect the absence of a single, logical approach for joint tax returns.

[14] Prop. Treas. Reg. §1.163(j)-7(f)(6)(i).

In addition, it is a matter of frequent discussion by legislators, practitioners and commentators that joint returns sometimes result in a "marriage bonus" and other times in a "marriage penalty,"[15] suggesting that the proper benchmark is the extent to which Code §6013 results mirrors the results that would obtain for individual taxpayers filing separately, but simultaneously recognizing that in practice the rules frequently diverge from that standard and that the actual result depends on the particular Code provisions in question.

Married Couple as a Single Unit

The following cases and rules treat a married couple as a single unit, meaning as though they were one taxpayer.

- In *Taft v. Helvering*[16] the Supreme Court held that I.R.S. Regulations, providing that a 15%-of-net-income limitation on charitable contributions should be determined vis-à-vis each spouse's standalone taxable income, were inconsistent with the concept of a joint return, and overturned them.

- In *Estate of Hooks v. Commr*.[17] the Tax Court ruled that, where two statutory provisions of the Tax Code then in effect granted a surviving spouse a right to deduct interest on a final joint tax return, the I.R.S. could not deny her the deduction based on the argument that the deduction did not belong to her because it was her spouse who took the loan out against his insurance policy before death.

- In *Helvering v. Janney*[18] the I.R.S. enacted Regulations in 1935 which were at odds with prior legislative enactments and its own longstanding practice, and sought in reliance on those Regulations to prevent a husband and wife from offsetting their respective capital gains and losses (clearly, the language in current Treas. Reg. §1.6013-4(b) was added later). The Supreme Court refused to apply the Regulations and allowed the taxpayers to offset their capital gains and losses.

- In *Ross v. Commr*.,[19] the Tax Court considered whether a married couple filing a joint return could claim a duplicate $1,000 (or in all, $2,000) benefit for offsetting capital losses against ordinary income. The statute and regulations were clear that only a single $1,000 offset was available, but the taxpayers challenged this rule based on residence in a community property state. The Court ruled against the couple, citing the B.T.A.'s opinion in *Marvin L. Levy v. Commr*.:[20]

  > It would be a peculiar logic to permit the "joint" return to give the benefit of offset of gains and losses not available to the individual by merging all items, including capital gains and losses

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15 For example, Alan Appel and Joshua Gamboa discuss a marriage penalty relating to high-income taxpayers under the T.C.J.A. in their article in Tax Notes, "The Hidden Marriage Penalty Inside the T.C.J.A.", dated Aug. 3, 2020.

16 311 U.S. 195 (1940).

17 22 T.C. 502 (1954).

18 24 A.F.T.R. 1073, 61 S. Ct. 241 (1940).

19 37 T.C. 445 (1961).

20 46 B.T.A. 1145 (1942).

> of the spouses, yet to say that in one very particular respect, the limitation on capital losses, there is no such merger, and that the identity of the taxpayer is preserved so that each can individually take a deduction of $2,000 [the present amount is $1,000] capital losses. . . . The limitation, like the offsetting of gains and losses, is not separate, but a part of the method of computation of the income under the integrated return.

"[S]ome authorities aggregate spouse's interests or implicitly treat them as owning each other's property even where no joint return is filed. . ."

- In *McClure v. U.S.*,[21] the Fourth Circuit ruled that a special provision providing for a lower tax rate where 80% of a payment for services delivered over a long period was paid within a period no longer than 36 calendar months, both the taxpayer who performed the services and his spouse would be eligible for the lower tax rate. The statute (Former Code Section 107(a)) expressly provided that the income earned could be split between the spouses to produce a greater benefit, even if the spouse did not perform any services. The Fourth Circuit ruled that the split could be applied for all of the years over which the services were performed, even if the taxpayers were not married or had not selected to file a joint return in all those years.

- In *Anderson v. Commr.*,[22] the Tax Court considered whether a marital couple's alternative minimum tax exemption amount was doubled under the 1954 Code when they live in a community property State. The Tax Court observed as follows:

  > The Code is replete with examples of situations similar to that presented [here] * * * whereby married individuals filing separate returns receive only one-half of a benefit available to single persons and jointly filing individuals,.* * * Where Congress intends to grant married persons filing jointly twice the benefit of single individuals, it has been clear and unambiguous.

- In Rev. Rul. 75-356[23] and P.L.R. 7813073, the I.R.S. concluded that farmers who filed a joint return had to aggregate both spouses' income to determine whether more than two thirds of his income came from farming, which was necessary to discern whether the taxpayer qualified as a farmer under Former Code §6073(b) of the Code. As such, after aggregating the spouses' income the farmer failed the test.

In addition, some authorities aggregate spouse's interests or implicitly treat them as owning each other's property even where no joint return is filed, such as the basis-leaping rule of Code §302[24] or Code §469's active participation requirement.[25]

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21 228 F.2d 322 (4th Cir. 1955). Similar issues involving application of Former Section 107(a)'s benefit by joint-filing spouses to separate filing years seem to be at issue in *Ford v. Commr.*, 217 F.2d 886 (9th Cir. 1954).

22 77 T.C. 1271 (1981).

23 1975-2 C.B. 497.

24 Treas. Reg. §1.302-2(c).

25 In addition, in the case of nonstatutory stock options ("N.S.O.'s") and nonqualified deferred compensation transferred to a former spouse incident to a divorce, the I.R.S. provided in Rev. Rul. 2004-60 that F.I.C.A., F.U.T.A., and income tax withholding, in addition to reporting requirements, are triggered on the nonemployee spouse's exercise of N.S.O.'s and distributions from the nonqualified deferred compensation plan, and are treated as remuneration for Code §3402 purposes. Because the nonemployee spouse includes these amounts in gross income, the spouse is also entitled to a credit for income tax withheld under Treas. Reg. §1.31-1(a).

Married Couple as Aggregate of Two Individuals

An opposing stream of authorities respects spouses' separateness, or requires them to apply or qualify under various provisions independently:

- A seminal case about maintaining distinctions between spouses filing a joint tax return is *Coerver v. Commr.*,[26] where the spouses sought a Code §162 trade or business deduction for the wife's travel between her work in New York City and the couple's home in Wilmington, where her husband resided year-round. The Tax Court rejected the spouses' position that costs of maintaining a N.Y. apartment and traveling to and from Delaware constituted living expenses away from home within Code §162, since it was the wife's choice to work in New York and reside with her husband, not a requirement of her employer:

> It may be true that a joint return is to be treated as the return of a "taxable unit" and as though it were made by a "single individual," but this merely means that the husband and wife are permitted to aggregate their income and deductions in a joint return. * * * This may have the result in instances, of permitting the losses or deductions of one spouse to offset the income of the other spouse * * * but each spouse must first be entitled to a particular deduction before it can be aggregated. The concept of a "taxable unit" under the joint return provision, [Code §]6013, merely means that while there are two taxpayers on a joint return, there is only one taxable income. It does not create a new tax personality which would be entitled, in its own right, to deductions not otherwise available to the individual spouses under the pertinent sections of the statute.

- P.L.R. 8920019 addresses a fact pattern involving the filing of a joint tax return by two spouses, one of whom was insolvent for purposes of Code §108(a)'s insolvency exclusion. Citing *Coerver*, the I.R.S. held that the joint return filing did not convert the assets of both spouses into assets of the insolvent spouse, for determining insolvency, because the bankruptcy statute looked only to that spouse's assets and did not allow the insolvent spouse's creditors to reach assets in the name of the solvent spouse.

- In Rev. Rul. 66-172,[27] the I.R.S. held that where husband (H) and wife (W) jointly owned an S Corporation as tenants by the entirety, and each took income into account under Subchapter S, following which H died, W did not succeed to H's share of previously-taxed income ("P.T.I.") under old law S corporation rules because the I.R.S. explicitly provided – via Regulation – that the shareholder's right to non-dividend distributions was personal and non-transferrable. H and W had been filing joint tax returns for the years in question, and the I.R.S. cited Treas. Reg. §1.6013-4(b) for the principle that joint returns in no way changed the result under Subchapter S because a joint return is the return of two separate taxpayers.

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26 36 T.C. 252 (1961), *aff'd*, 297 F.2d 837 (3d Cir. 1962).

27 1966-1 C.B. 198.

- Code §911's foreign earned income exclusion depends on activities undertaken by either spouse, and each determines their excludable foreign earned income under Treas. Reg. §1.911-3; if they live together, the spouses may elect to compute their housing cost amount jointly or separately. Each completes a separate Form 2555.

- Treas. Reg. §1.6017-1 requires spouses filing a joint return not to compute their self-employment tax on an aggregate basis.

- Dual-status individuals who are not U.S. tax residents at the close of a tax year and who are married to a U.S. citizen or resident may make a joint election with their spouse under Code §6013(g) to be treated as a U.S. resident for certain purposes of the Code (Income Tax and Wage Withholding). Under such an election, income of both spouses is included in modified adjusted gross income as well as in net investment income for Code §1411 net investment income tax; however, whether the U.S. taxpayer is independently subject to tax under Code §1411 is made without regard to the election or the non-resident spouse's income.

- Both Courts and the I.R.S. have consistently ruled that where a husband and wife file a joint return and pay tax, there is no joint interest in overpayments. For example, in Rev. Rul. 74-611, a married couple filed a joint tax return and the wife paid the entire amount of tax liability, subsequently determined to be an overpayment which the husband attempted to apply to his own tax liability from a prior year before the couple were married or filed a joint return. The I.R.S. refused to allow the overpayment to be so applied.[28]

- The case of *McClamma v. Commr.*[29] recognized that the automatic stay under Chapter 11 of the Bankruptcy Code did not extend to the spouse who did not file a petition in bankruptcy.

- Innocent spouse relief provisions under Code §6015.

- For a married couple one or both of whom are nonresident alien individuals who earn community income for a taxable year, Code §879 treats them as each earning the income each earned on a separate basis for some purposes, for example, trade or business income treated as community income under Code §1402(a)(5) is treated as gross income of the spouse carrying on the trade or business, or if jointly operated by both spouses, then on the basis of their respective distributive shares.

CONCLUSION

Filing a joint tax return under Code §6013 and netting tested income of C.F.C.'s owned by one spouse with tested losses of C.F.C.'s owned by the other spouse without more justification sounds like a good idea at first. However, those who have read the cases may have a different view. This approach may be compared to a person jumping into a swimming pool with a blindfold on and without checking the water level in the pool – there may be logic to the act, but it is fraught with danger.

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[28] 1974-2 C.B. 399.

[29] 76 T.C. 754 (1981).

The cases applying Code §6013 are not consistent when the issue is the status of the married couple as a single unit or an aggregate of two taxpayers. Hence, a taxpayer who assumes that a couple should be treated as one unit does so on faith, believing that the aggregation principle must cover G.I.L.T.I. calculations. The rational answer is that aggregate treatment may be the answer, but until Congress or the I.R.S. take action, a risk exists that a different view could prevail.

As indicated above, there is a natural and logical way to harmonize the provisions of Code §§951A and 6013 in order for the spouses in H and W's position to offset tested income and tested loss, in a manner that does not require potentially structural changes that are costly.

In short, the I.R.S. should lend greater clarity to this area via guidance in any format it deems appropriate. The guidance could provide that the married couple will be treated as owning C.F.C.'s on a 50/50 basis for G.I.L.T.I. purposes, but could also leave room for couples to elect out of that treatment and compute separate G.I.L.T.I. inclusions while filing a joint return. In a 2000 Senate discussion about proposed legislation to eliminate certain marriage penalties, a Democratic senator cited 65 different provisions that, in context, constituted a penalty for married taxpayers filing jointly. By issuing guidance on this G.I.L.T.I. issue, the I.R.S. would remove one more potential penalty from the Code.