

Wedding bells might give you the tax blues

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First comes love, then comes marriage, then comes Uncle Sam with his hand out.

Despite efforts by Congress to reduce the marriage penalty, some newlyweds -- mainly those with two good-sized incomes -- will pay more in taxes after they get hitched than they did as two singles combined. Some high-income couples could even find their wedding crashed by the alternative minimum tax.

On the other hand, a couple could pay less tax post-nuptials if one earns considerably more than the other. Two low- or middle-income spouses with comparable incomes would likely see no change.

With wedding season in full swing, it's a good time to look at the impact of marriage on taxes and whether newlyweds should adjust their income-tax withholding to reflect their new tax status.

Because the federal government doesn't recognize same-sex marriage, the following applies only to heterosexual couples.

Filing options: Even if you keep separate checking accounts, you must file your federal income taxes as either married filing jointly or married filing separately.

Filing separately doesn't usually lower a couple's tax bill unless one spouse has certain large deductions, such as for medical expenses or casualty losses. Couples filing separately can lose some tax benefits such as the student loan interest deduction and the education, dependent care and adoption credits, so it's not commonly done.

If you and your spouse file a joint return, you are each legally responsible for both of your taxes. If you file separately, you are liable only for your share.

If you think your spouse is a tax cheat or might flee the country, leaving you with a big tax bill, consider filing separately.

Assuming newlyweds haven't reached that point, for the rest of this column, married means married filing jointly.

Marriage penalty: In 2001 and 2003, Congress took steps to reduce the marriage penalty.

It made the standard deduction exactly twice for marrieds what it is for singles.

It also adjusted the lower tax brackets so married couples reach them when they have twice as much taxable income as singles. For example, the 25



percent bracket starts at \$31,850 for singles and \$63,700 for joint returns.

However, the penalty still exists in the higher brackets.

The 28 percent bracket starts at \$77,100 for singles. For married, it's \$128,500, which is less than twice the single amount.

"If each spouse had \$70,000 in taxable income, as singles they would be in the 25 percent bracket, as married, they would be in the 28 percent bracket," says Bob Scharin, RIA senior tax analyst from Thomson Tax & Accounting.

On the other hand, a high-income person could pay less tax with a low-income spouse.

Suppose the wife has \$100,000 in taxable income and the husband has none. As a single, she would be in the 28 percent bracket. After marriage, the rate drops to 25 percent, Scharin says. This is called the marriage bonus.

"Sometimes, over the course of someone's marriage, they can flip back and forth" between the penalty and bonus, Scharin says.

As newlyweds, they might both have modest incomes, so their taxes don't change after marriage. Over time, their incomes grow and they owe a marriage penalty. Then they have a child and one spouse stops working, so they have a large disparity in income and enjoy a marriage bonus.

Eugene Steuerle, a senior fellow with the Urban Institute, points out that marriage-penalty relief, like many provisions in the 2001 and 2003 tax acts, expires after 2010. "My sense is that Congress will maintain the marriage penalty relief," he says, but there are no guarantees.

The AMT: Marriage could throw some higher-income people into the alternative minimum tax, which essentially levies an additional tax on top of your regular tax.

"There are situations where individually, neither owes AMT, but when you add your incomes together, you could owe AMT," Scharin says.

The reasons are complicated, but it essentially can happen because "the AMT exemption amount (similar to a standard deduction) is not twice for married what it is for single," he notes.

Time to itemize? Some people who had been taking the standard deduction might benefit from itemizing after marriage. For 2007, the standard deduction is \$10,700 for joint returns and \$5,350 for singles.

If you have \$4,000 of deductible expenses and your spouse has \$8,000, you should itemize after marriage, so be sure to retain receipts for deductible expenses, Scharin says.

On the other hand, if you have \$7,000 in deductions and your spouse has only \$3,000, you will no longer be itemizing.

Capital losses: If your capital losses for the year exceed your capital gains, you can deduct up to \$3,000 in excess capital losses from your ordinary

income. Capital losses of more than \$3,000 can be carried forward to be used in future years.

The \$3,000 limit applies to both singles and married couples.

If you both sold some bad investments and have a lot of capital losses in excess of your gains, as two single people you could deduct a total of \$6,000 from your ordinary income. As a married couple, you can deduct only \$3,000. You can still carry unused capital losses forward so you don't lose them, it just takes longer to use them.

What about kids? Couples could lose some tax benefits if there are children from a previous marriage.

A single person can contribute up to \$5,000 per year before taxes to a dependent care reimbursement account at work to pay for child care expenses.

The limit for married couples is also \$5,000.

If a husband and wife had each been setting aside \$5,000 before marriage, their combined contribution was \$10,000. After marriage, they are limited to \$5,000.

Couples might need to reduce one spouse's contribution after marriage. Most plans allow changes midyear if the employee has a change in circumstances.

Contributions to these plans, also called flexible spending accounts, are exempt from Social Security and Medicare tax as well as income tax.

If one spouse earns more than the Social Security wage base (the annual income that is subject to these taxes) and one earns less, the spouse who earns less should contribute up to \$5,000 and the spouse who earns more should contribute nothing.

This way, the lower-earning spouse gets the full benefit of the exemption from Social Security and Medicare tax. For 2007, the wage base is \$97,500.

People who had been taking the child care tax credit (usually in lieu of contributing to a dependent care account) also could see a change after marriage.

The dependent care tax credit can be applied against up to \$6,000 in expenses for two or more children, regardless of filing status.

If each spouse has two or more children, before marriage they could apply the credit to \$12,000 in annual child care expenses. After marriage, they can apply it to only \$6,000.

IRAs: Some people might have to stop contributing to an individual retirement account after marriage. Others might become eligible.

Your eligibility to contribute to a regular deductible IRA or a Roth IRA depends on your income and whether you are eligible for an employer-sponsored retirement plan such as a 401(k).

The income limits are higher for married people than singles.

"It could be that one person could not make a contribution as a single person because he or she earned too much, but with a lower-earning spouse, now they could," Scharin says. "On the other hand, a lower-earning spouse could find that marrying a rich person makes him or her ineligible"

The rules are in IRS Publication 590 at links.sfgate.com/ZGT.

Check it out: Newlyweds can use the IRS withholding calculator to estimate their post-wedding tax liability. If a big change is in store, they might want to adjust their withholding to avoid getting a big tax bill or refund next year.

The calculator is at links.sfgate.com/ZGU.

Unfortunately, it won't give accurate results if you are subject to AMT or self-employment tax or if any of your jobs will end before the end of the year. In those cases, the IRS recommends using Publication 919, How Do I Adjust My Tax Withholding?

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