Welcome to Edition 6 of The Newsletter from Scott H. Novak, Attorney at Law. The Newsletter is designed to bring timely and interesting topics to accountants, attorneys and clients. Comments and suggestions are always welcome. Feel free to call or write at any time.

Innocent Spouse or Injured Spouse? These two terms can create quite a bit of confusion. First, where do they arise from? Both terms are related to joint federal income tax returns. Many people don't fully understand the consequences of signing a joint income tax return. Doing so makes you jointly and severally liable for the tax due with that return and any additional tax, penalty and interest that may arise from an audit. If you, for example, are a W-2 wage earner, it is likely that your employer withholds and pays over income taxes on your behalf. But what if your spouse is self-employed, earned $250,000 and paid no tax in? It could be that come April 15, there is a big tax bill and no money to pay. Even though the tax deficit on your return is due to your spouse, you are liable for it because you signed a joint return. Now that's love!

Let's take this one step further. You are completely uninvolved in your spouse's business and out of the $250,000 in gross income, your spouse had deductions of $240,000 and reported $10,000 of taxable income. You sign the return, all taxes due with the return are paid. Then there's an audit and it turns out that some of those big deductions were, well, fictitious, and you get hit with a bill of $80,000 for tax, penalty and interest. You knew nothing about this, but are still liable because of that pesky joint and several liability. Except - if you were what we call an "innocent spouse," meeting IRS requirements too numerous and detailed to list here, you might be able to get out of joint and several liability. Application for innocent spouse protection is made on Form 8857.

So, then, who is an "injured spouse?" This is different from innocent spouse. You are potentially an injured spouse if there is a refund shown on your joint income tax return attributable to you, that the government is intending to keep for something attributable to your spouse. For example, your income tax return shows a refund of $8,000 and you can show that the refund is attributable to you. Your spouse, however, owes $10,000 in child support. The federal government intends to take that refund and use it as an offset for the child support. You can fill out Form 8379 to show that you should get the refund because the debt is not yours, but the refund is. This applies to certain debts, such as federal tax, state income tax, state unemployment compensation, child support, spousal support and federal nontax debt (such as a student loan).

Guns and Ammo. The City of Seattle enacted a law in 2015 that imposes a tax of $25 on every gun sold in Seattle and a tax of either 2 or 5 cents per round of ammunition sold. Some gun stores moved out of the city. As you might imagine, there were plenty of opponents to the law and off to court it went. Plaintiffs were, for example, the NRA, Second Amendment Foundation, the National Shooting Sports Foundation and two local gun owners. The main argument by the opponents is that a State of Washington law bans cities from regulating firearms. That authority is reserved for the state. Seattle's defense is that this is a tax, and a tax is different from regulation. The case made its way to the Supreme Court of the State of Washington, where the tax was upheld. The Court found that the City's ordinance does impose a tax, rather than a regulation, on firearms because its primary purpose is to raise revenue for the public benefit. The court also stated that, "while courts should be dubious of regulations masquerading as taxes (and vice versa)," the opponents offered "no convincing evidence that the ordinance has a regulatory purpose or intent."

How a Beneficiary Designation Can Have Unintended Consequences. Every bank in which you open an account asks you how you would like your account titled. Brokerage houses do this too. It is very common to create a "payable on death (POD)" designation on an account and when you open the account, it may seem like the best thing to do. And sometimes it is. Another common change that is made is when, for example, you have an elderly parent who is having trouble keeping track of the bills. Some are going unpaid, some are being paid twice. In that instance, you might be added as a joint account holder so that you can take over paying the bills. There is good reason for taking these actions in certain instances, but what might it do to an estate plan?

Let's say that you are finally getting around to doing that will. You have three children and would like to leave equal one-third shares of your estate to each of them. Your attorney drafts the will, one-third of your estate will go to each child and everything looks to be in order. But just a minute. That brokerage account with substantial assets in it lists your oldest child as the beneficiary on the account and your bank accounts are held jointly with your youngest child who is paying your bills out of that account. Watch what happens. When that day comes, your brokerage account and the bank accounts pass outside the will to the people listed as beneficiaries, joint account holders or PODs. In essence, you just undid your entire estate plan and your children are getting anything but the one-third that you wanted to give to each. And then the fighting begins. Make sure you carefully consider how your assets are titled when making an estate plan to avoid unintended consequences.

There are some assets, such as an IRA, 401(k) and life insurance policy, that will always require a beneficiary designation. While it is possible to name your estate as the beneficiary, ultimate beneficiaries may lose some positive tax benefits if you do this, such as the post-death IRA distribution rules. For assets like this, consider designating beneficiaries in a manner similar to what your will states.

Celebrity Estates. I wrote about the Michael Jackson estate tax controversy before, where the Jackson estate claimed that Michael's name was worth $2,105 at his death and the IRS claimed that it was worth $434 million (before interest and penalties). Tax and estate lawyers and valuation experts are watching this case very carefully, considering what may be in the tax pipeline. The estates of Whitney

Houston, Prince, Debbie Reynolds and Carrie Fisher, just to name a few, will all face similar issues down the road.

Post Polak Goodsell & Strauchler P.A.
425 Eagle Rock Avenue, Suite 200, Roseland, NJ 07068
134 Nassau Street, Princeton, NJ 08542
(973) 228-9900