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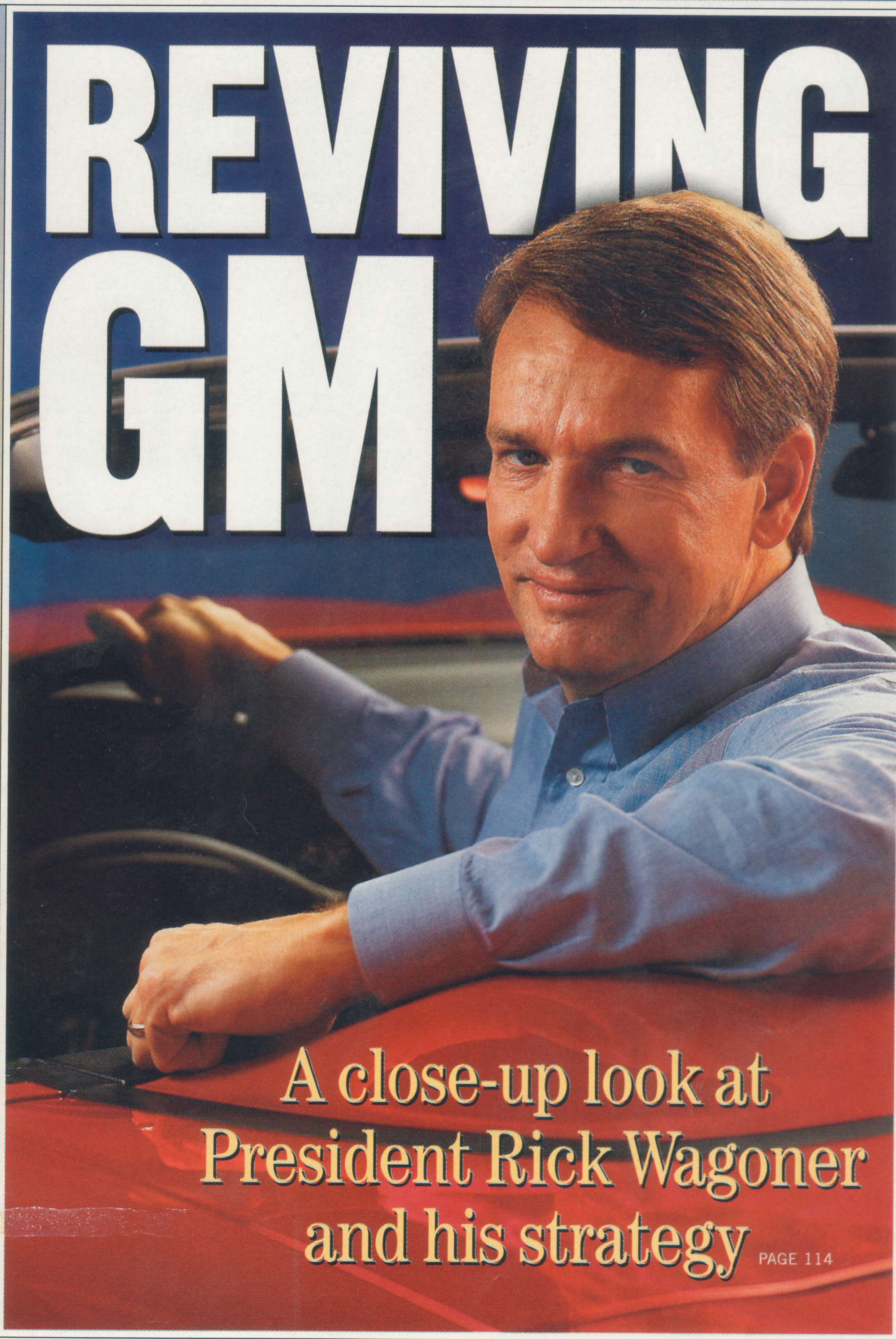

A close-up look at President Rick Wagoner and his strategy PAGE 114

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Your Taxes

TAX PLAYS FOR UNMARRIED COUPLES

We're at the brink of a new century, but the U. S. tax code is still based on the idea of the 1940s nuclear family, with Dad working and Mom staying home to take care of the kids. For such traditional families, there are definite tax advantages to being married and filing jointly. Then there's everyone else.

In fact, the well-publicized marriage penalty, in which dual-income couples often end up in higher tax brackets than singles earning the same total amount, is so onerous that many wonder whether they might be better off not getting married. Of course, there are many financial and legal—not to mention emotional—reasons to get hitched. But heterosexual partners who choose not to marry, or gay couples who can't, can use several tax-planning strategies not available to married couples.

For federal income taxes, one strategy calls for structuring the family finances so that the partner with the larger income, who probably is in a higher bracket, pays most of the deductible expenses. That will get the most mileage for deductions—and improves the chances that the other partner would benefit from taking the standard deduction, which was $4,250 for singles in 1998.

Of all the itemized deductions available, mortgage interest and property taxes can make the biggest difference, says James Davis, a San Francisco financial and tax adviser. He often recommends that the higher-income partner write all the checks for such expenses. Even if a residence is jointly owned, this strategy works as long as both partners are legally liable for the payments, he says. "The key thing is who paid the bills—who has the cancelled checks." But this tack generally can't be used for rental property the couple owns, which would be subject to different tax rules. Shifting deductible expenses to the higher-income partner could be used for charitable contributions too, says Tom Ochsenschlager, a tax partner at Grant Thornton in Washington.

Expense-shifting works particularly well when there's a big gap in incomes. High-income couples and those facing the alternative minimum tax would run into limits on itemized deductions and may not find the strategy advantageous, says Davis. (Itemized deductions start phasing out at $124,500 in 1998.) The strategy also may make less sense in states such as California and New York where high local taxes mean both partners should itemize deductions.

For taxes on investment gains, marital status is a mixed bag. Income ceilings for rolling over a traditional individual retirement account into a Roth IRA are the same for married or single filers, so unmarried couples are more likely to qualify. But being married usually is helpful when it comes to investment taxes. A spouse's net loss can offset capital gains in the partner's separate account, Ochsenschlager says.

SENIOR HURDLES. Senior citizens often find tax laws stand in the way of getting hitched. A new marriage can complicate estate planning for couples who plan to leave most of their assets to kids from previous unions. Marriage also may reduce Social Security payments. But for couples who want to leave the bulk of their estates to their partners, there is a huge advantage to being married: Entire estates can pass tax-free to the surviving spouse. Unmarried couples need to write air-tight wills and other legal documents to make up for this major penalty, says Karen Altfest, a financial planner in New York.

Unmarried couples are also at a disadvantage when one individual is staying home to care for children. The earning partner generally would claim head of household, a tax status for unmarried people who pay most of the costs for supporting another. Rates for head of household are generally lower than for singles, but not as low as the rates for married couples filing jointly. The working partner generally would claim the exemptions ($2,700 per child in 1998). A child need not be a relative if he or she has been a member of your household for the entire year, and you provide more than half the child's support.

Tax issues shouldn't play much of a role in a decision to get married. But if you and your partner can't legally marry or decide against it, you still can gain some tax advantages. *Amey Stone*

Reducing The Bite for Partners Who Aren't Hitched

- Have the higher-income partner pay the mortgage and property taxes to make best use of the related deductions
- Also let the higher-income partner make the charitable donations to reap the greatest tax benefit
- Look into whether the higher-income partner should file as head of household and claim any children as dependents
- By shifting deductions to the higher-income partner, see if the other one can benefit from taking the standard $4,250 deduction for singles

DATA: JAMES DAVIS, BUSINESS WEEK

TAX TIP The value of assets you can pass to heirs tax-free will rise to $650,000 in 1999, on its way to $1 million in 2006. Be sure to adjust your will to the new limits