MARRIAGE AND THE INCOME TAX

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I. INTRODUCTION

The federal income tax treats a married couple as a single economic unit. Spouses report their combined income on a joint return, and calculate their tax liability based on that combined income. Married couples will often have a tax liability different from the combined tax liabilities the spouses would have if single. These differences are called marriage penalties and marriage bonuses.

It is impossible to have an income tax with progressive marginal rates and joint returns for married couples, and avoid marriage bonuses or penalties. Progressivity means that, as more income is added to a taxable unit, increasingly higher tax rates apply to the added amounts of income. Thus the designation of taxable units affects tax liability. And joint returns mean that marriage affects the

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1. I.R.C. § 1(a) (West Supp. 1993). Unless otherwise noted, all references in this Article are to the current version of the Internal Revenue Code. Spouses do have the option of filing separate returns, under I.R.C. § 1(d), but the tax rates are designed so that the combined separate-return tax liabilities will be at least as great as their joint-return liability. Separate returns may result in lower total tax liability, however, in the unusual situation where the use of separate returns reduces total taxable income reportable by the couple. This occurs when an expense is incurred by one spouse, and the expense is deductible only to the extent that it exceeds some specified percentage of adjusted gross income. Examples include miscellaneous itemized deductions, I.R.C. § 67(a); casualty losses, I.R.C. § 165(b)(2); and medical expenses, I.R.C. § 213(a). Separate returns can reduce the percentage floor, thus increasing the amount of the deduction and decreasing taxable income. Even then, however, the separate-return advantage of reducing taxable income may be more than offset by the disadvantage of higher rates.

2. It is possible, however, to design a tax with a limited amount of progressivity created by features other than progressive marginal rates, which could use joint returns without causing marriage penalties or bonuses. Such systems are described and discussed infra part V. I conclude that they are not attractive, despite their ability to solve this particular dilemma.

3. By contrast, amounts of tax liability would not depend on taxable units under a strictly proportional (flat) tax system. If all income is taxed at 20%, ten dollars of income will always generate two dollars of tax, regardless of the taxable unit to which it is assigned.
designation of taxable units, making bonuses or penalties unavoidable. A joint return system cannot be marriage neutral.

The crucial factor governing the extent of the marriage bonuses or penalties created by joint returns is the degree of income splitting allowed between spouses. Under a progressive tax, two single persons with any given amount of combined income will pay the lowest combined tax if their income is divided evenly between them. Shifting income away from an even division will increase their combined liabilities, because the marginal rate of the taxpayer to whom income is moved will be higher than the marginal rate of the taxpayer from whom income is moved. The highest marginal rates, and thus the highest combined liabilities, will result from all of the combined income being taxed to one person.

A joint-return system can be designed to have only marriage bonuses by making the tax rate brackets for married couples twice as wide as the brackets for single taxpayers. The effect is the same as allowing two single persons to split their incomes evenly between them. A joint-return system could also be designed to produce only marriage penalties by taxing combined spousal income at the same rates applicable to a single taxpayer. The effect is the same as requiring two single persons to report their combined income on one person’s return. Or, a joint-return system could be designed with marriage bonuses in some situations and marriage penalties in others. This could be accomplished by a joint-return rate schedule whose brackets are wider than the brackets for single taxpayers, but less than twice as wide. The current law takes this approach. Spouses with equal incomes will suffer a marriage penalty because they will lose the perfect income split they would have had as single taxpayers. But a one-earner couple will be allowed a measure of income splitting, and

4. For example, if the first $10,000 of taxable income of a single taxpayer is taxed at 15%, the first $20,000 of taxable income of couples would be taxed at that rate. Such a system was in effect in the United States from 1948 to 1969. The system was introduced by the Revenue Act of 1948, Pub. L. No. 80-471, tit. III, pt. I, 62 Stat. 110, 114-16. The 1969 legislation moved to a system which produces marriage penalties in some cases and bonuses in others. Tax Reform Act of 1969, Pub. L. No. 91-172, § 803, 83 Stat. 487, 678.

5. For example, if the first $10,000 of taxable income of a single taxpayer is taxed at 15%, the 15% bracket for a couple would also cover only their first $10,000 of income.

6. If the first $10,000 of taxable income of a single taxpayer is taxed at 15%, a couple might be allowed a 15% bracket of $15,000 (or any amount greater than $10,000 and less than $20,000).

7. Compare I.R.C. § 1(a) rates for married couples with I.R.C. § 1(c) rates for single persons. For example, the first $22,100 of taxable income of a single person is taxed at 15%, while the first $36,900 of a couple’s taxable income is taxed at that same rate.
will enjoy a marriage bonus.\(^8\) The more progressive the rate structure, the more significant the tax effects of joint returns. Effects that may have been tolerable under the low rates of the 1986 Tax Reform Act may not be tolerable under the 36\% and 39.6\% tax rates introduced by the Omnibus Budget Reconciliation Act of 1993.\(^9\) At high income levels, marriage penalties can range into five figures, and can exceed ten percent of a married couple’s total tax liability.\(^10\) Anecdotes of high income couples considering divorce to save taxes have appeared in the media, as has speculation that the new rates will discourage wives of high income husbands from taking or keeping jobs.\(^11\) Given

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8. Assume a couple has combined income of $40,000, no itemized deductions, and no dependency exemptions. At 1993 rates, their joint-return tax liability is $4,365, regardless of how the income is distributed between them. (All calculations take into account the inflation adjustments of Rev. Proc. 92-102, 1992-52 I.R.B. 20.) Two single persons, each with a $20,000 income, would have combined tax liabilities of $4,185; thus, they would face a $180 marriage penalty. Two single persons, one with a $40,000 income and the other with no income, would have combined tax liabilities of $6,633. (This calculation assumes the person with income could not claim a dependency exemption for the other person. I.R.C. § 152(b)(5) denies a dependency exemption if the relationship between the taxpayer and the would-be dependent violates local law. If a dependency exemption is available, the combined tax liabilities would be $5,975.) Marriage would give them a tax bonus of $2,268. At $60,000 combined income, the maximum marriage penalty is $1,285 ($8,951 joint-return tax, compared with two $3,833 taxes on two $30,000 incomes), and the maximum marriage bonus is $3,295 ($8,951 joint-return tax, compared with $12,246.50 tax on one $60,000 income). At $80,000 combined income, the maximum marriage penalty is $1,285 ($14,551 joint-return tax, compared with two taxes of $6633) and the maximum bonus is $3,895.50 ($14,551 versus $18,446.50). At $100,000 combined income, the maximum penalty is $1,285 ($20,151 versus $9,435 twice), and the maximum bonus is $4,495.50 ($20,151 versus $24,646.50). The break-even point—the division of income at which there is neither a marriage penalty nor a marriage bonus—varies slightly with combined income level. At $40,000 combined income, the break-even point is a 74%-26% division. At $60,000, it is 70%-30%; at $80,000, 77%-23%; and at $100,000, 78%-22%.


10. At $300,000 combined income, the maximum marriage penalty is $11,565.22 ($95,328.50 versus two taxes of $41,881.64). By contrast, the maximum marriage bonus is only $4,243.50 ($95,328.50 versus $99,572). All calculations reflect the phaseout of personal exemptions pursuant to I.R.C. § 151(d)(3). The size of the maximum marriage penalty is partly due to the fact that the 39.6% bracket begins at exactly the same income level ($250,000) for single and married taxpayers. I.R.C. § 1(a), (c).

this recent increase in the tax consequences of marriage, and the increase in public awareness of the phenomenon, it is time to reconsider how the income tax treats marriage.

The only way to avoid both marriage bonuses and penalties is to abandon marital status as a tax determinant and to require that spouses file separate returns. However, this would mean that different couples with the same combined incomes, but different income distributions between husband and wife, would be taxed differently. If one believes that a married couple functions as a single economic unit, then one will subscribe to the principle of couples neutrality: Equal-income couples should pay equal taxes. Separate returns, of course, violate that principle. Hence the dilemma: There is no way to design an income tax which (1) is progressive, (2) achieves marriage neutrality (no marriage bonuses or penalties), and (3) achieves couples neutrality. Progressivity means it matters how income is assigned among taxable units; marriage neutrality means marriage does not affect that assignment; and couples neutrality means marriage does affect the assignment. The incompatibility is apparent.12 The argument for the present system is that progressivity and couples neutrality are the most important goals, and if a goal must be sacrificed, it should be marriage neutrality.13

As Boris Bittker has observed, the choice between marriage neutrality and couples neutrality cannot be made purely on the basis of tax logic, but must consider “society’s assumptions about the role of marriage and the family,” and “in the end can rest on nothing more precise or permanent than collective social preferences.”14 In this Article, I argue that American society at the end of the twentieth century would be better served by separate returns.

The Article begins by examining some weaknesses in the case for joint returns. The adoption of a joint-return system in 1948 was an ad

low income working couples created by the design of the earned income tax credit); Taxing Wedded Bliss, Fortune, Sept. 6, 1993, at 40 (“[F]or America’s rich, one way to spell tax relief is now D-I-V-O-R-C-E . . . .”).


hoc response to tax discrimination between residents of community property and separate property states, caused by two Supreme Court opinions. What is now the standard justification for joint returns—that a couple acts as an economic unit by pooling its resources, and should be taxed accordingly—was developed only as an after-the-fact rationalization. The evidence on marital pooling suggests that, although spouses may share the consumption of resources rather evenly, the control over income remains with the earner. In an income tax, control should govern, not consumption.

The Article then compares the frequent public complaints against the marriage penalty of the income tax with the absence of complaints against the violation of couples neutrality by the separate-taxpayer social security tax system. This comparison strongly suggests that given current attitudes the income tax has made the wrong choice in the battle of the neutralities.¹⁵

Next the Article considers the differing behavioral effects of joint and separate returns. The current system strongly discourages a married woman from seeking employment¹⁶ by stacking her income on top of her husband’s, so that even her first dollar of income is taxed at a high marginal rate.¹⁷ The system thus appears to take sides on one of the most divisive of current social issues by pushing couples towards the traditional family model and away from the two-earner model. Separate returns would let each spouse begin at the bottom of the rate schedule, thus removing the work disincentive effect on wives. There are other ways of addressing the work disincentive effect without abandoning joint returns, but they would be viewed as inappropriately taking the other side of the family model debate. Mandatory separate returns, by contrast, can be persuasively defended as reflecting governmental neutrality between traditional families and two-earner couples.

Finally, the Article discusses in some detail the problems of allocating property income and itemized deductions between spouses under separate returns. These problems are difficult precisely because


¹⁶. Throughout this Article I frequently refer to husbands and wives rather than making gender-neutral references to spouses. I do so advisedly, because one of my main points is that the joint-return system helps perpetuate traditional sex role differentiation in marriage. This point would be obscured by gender-neutral language.

¹⁷. This problem would exist even under a joint-return system that produced only marriage bonuses.
there is much marital pooling of consumption, so that the economic significance of which spouse owns property or incurs an expense is questionable. These issues are commonly glossed over by advocates of separate returns. The Article recommends taxing income from property to the spouse who owns the property, and allocating itemized deductions (and personal exemptions) between spouses according to a mandatory formula.

II. THE UNEASY CASE FOR JOINT RETURNS

The standard justification for joint returns is that the typical married couple pools its income.\textsuperscript{18} Since the couple acts as a single economic unit, it should be taxed as a single economic unit. The assumption that a married couple is an economic unit decides the winner in the battle of the neutralities. Horizontal equity—the like treatment of like taxpayers—requires that equal-income marital units pay equal taxes. At the same time, the comparison of tax liabilities (marriage penalties and bonuses) between a married couple and two single people, on which marriage neutrality analysis depends, can be dismissed as irrelevant. That comparison does not matter, because it is not a comparison of similarly situated taxpayers—the married couple is fundamentally different from the two single people, because the couple forms one economic unit, while the two single people do not.

This part examines the marital pooling justification for joint returns. It begins with a brief historical review, demonstrating that pooling was an after-the-fact rationalization for the joint return system. Next it considers the evidence on the reality of pooling, and finds that shared marital consumption of income seems to be the norm (although the evidence is surprisingly scanty). It concludes, however, that under an income tax, the relevance of who consumes the income—as contrasted with who controls or earns the income—is dubious.

A. A Historical Review

From its inception in 1913 until 1948, the income tax treated spouses as two separate taxpayers.\textsuperscript{19} In a progressive income tax system, separate spousal taxation created incentive for the shifting of

\textsuperscript{18} McIntyre & Oldman, supra note 13, at 1590 ("[E]qual-income couples should pay equal taxes, since each member of the couple will benefit more or less equally from the total available income without regard to the source distribution.") (footnote omitted).

\textsuperscript{19} This history is described in detail in Bittker, supra note 12, at 1399-1414.
income from a high income, high marginal rate husband, to a low income, low marginal rate wife (until enough income had been shifted to put both spouses in the same tax bracket). This could be accomplished, with respect to income from property, by a gift of the income-producing property from the husband to the wife. More important, however, was the question of whether income earned by the husband's labor could be shifted to the wife for tax purposes. In the 1930 case of *Lucas v. Earl*, the Supreme Court decided that earned income could not be shifted in a common law separate property jurisdiction—not even "by anticipatory arrangements and contracts . . . skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it." But later in the same year, in *Poe v. Seaborn*, the Court decided that in a community property state, half of the income earned by the husband was the income of the wife for federal income tax purposes. As a result, if two husbands had equal salaries and had wives with little or no income of their own (which was, of course, the norm), and one lived in a separate property state while the other husband lived in a community property state, the salary of the separate property husband would bear a significantly greater tax burden.

In the years following these decisions, a number of separate property states rejected centuries of tradition and adopted community property systems, thus entitling their inhabitants to the benefit of *Poe v. Seaborn*. Many states resisted, however, either out of concern for the havoc such a conversion might wreak or out of reluctance to give wives the rights inherent in community property. Husbands in separate property states attempted self-help income splitting, through both gifts of property and by making their wives business partners. This led to controversy and confusion regarding when a husband had given up sufficient control over property to make his wife the tax owner and

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21.  Id. at 115.
23. Oregon, Oklahoma, Hawaii, Nebraska, Michigan, and Pennsylvania all became community property jurisdictions and several other states were considering doing so when the 1948 joint-return legislation removed the incentive. Bittker, supra note 12, at 1411-12.
25. The leading cases concerning taxation of property income were Corliss v. Bowers, 281 U.S. 376 (1930), and Helvering v. Clifford, 309 U.S. 331 (1940). This area is now governed by the grantor trust provisions, I.R.C. §§ 671-678 (West Supp. 1993).
when family partnerships would be respected for tax purposes.\textsuperscript{26} Eventually, in 1948 Congress provided for automatic income splitting between spouses as a matter of federal income tax law.\textsuperscript{27} Under the new system, a married couple would have the same tax liability as two single persons, each with half of the couple’s income. This automatic perfect income splitting made state marital property law irrelevant, and all the states which had adopted community property after 1930 quickly recanted.\textsuperscript{28}

The Report of the Senate Finance Committee contains the official explanation for the 1948 change:

Adoption of these income-splitting provisions will produce substantial geographical equalization in the impact of the tax on individual incomes. The impetuous enactment of community-property legislation by States that have long used the common law will be forestalled. The incentive for married couples in common-law States to attempt the reduction of their taxes by the division of their income through such devices as trusts, joint tenancies, and family partnerships will be reduced materially. Administrative difficulties stemming from the use of such devices will be diminished, and there will be less need for meticulous legislation on the income-tax treatment of trusts and family partnerships.\textsuperscript{29}

In addition to these expressed concerns, commentators have suggested two unacknowledged motivations. Boris Bittker claims that Congress believed that income splitting would be accomplished one way or another—if not expressly by Congress, then by state legislatures adopting community property laws—and that if the result was inevitable, better for Congress to get the credit for the tax reduction.\textsuperscript{30} Carolyn C. Jones contends that Congress wanted to halt the movement to community property in order to prevent wives from obtaining increased property rights.\textsuperscript{31} Under this interpretation, Congress viewed the enactment of community property legislation as “impetuous” not so much because of its haste or because of transitional

\textsuperscript{26} The family partnership litigation is described in Jones, \textit{supra} note 24, at 274-93. The leading cases were Commissioner v. Tower, 327 U.S. 280 (1946), Lusthaus v. Commissioner, 327 U.S. 293 (1946), and Commissioner v. Culbertson, 337 U.S. 733 (1947).
\textsuperscript{27} Revenue Act of 1948, \textit{supra} note 4.
\textsuperscript{28} Note, Epilogue to the Community Property Scramble: Problems of Repeal, 50 \textit{COLUM. L. REV.} 332, 332 n.4 (1950).
\textsuperscript{29} S. REP. No. 1013, 80th Cong., 2d Sess. 25 (1948).
\textsuperscript{30} Bittker, \textit{supra} note 12, at 1413.
\textsuperscript{31} Jones, \textit{supra} note 24, at 295-96.
problems it might cause, but because it conferred unwarranted rights on women.

None of these motivations, expressed or unexpressed, has anything to do with the idea that spouses pool their income, act as a single economic unit, and should be taxed accordingly. Rather than being based on bedrock beliefs about the nature of marital sharing, the 1948 legislation was essentially a historical accident—a response to the geographic discrimination and legal confusion resulting from the combination of Lucas v. Earl and Poe v. Seaborn. If Seaborn had not permitted income splitting in community property states, there is no indication that Congress would ever have decided to treat a married couple as a taxable unit.

There may be two objections to this conclusion. First, the reasons for change stated in committee reports may not be the real reasons. Although this is true, the common pattern (exemplified by both the Bittker and Jones suggestions) is for Congress not to mention less noble reasons for change. Congress does not commonly omit respectable reasons for change, even if they are not the real reasons. If marital pooling had occurred to Congress it would have appeared in the Senate Report, for it certainly would have been a respectable justification.

The second objection is that the expressed concern for geographic uniformity could be taken as a concern that equal-income spouses in different states pay equal taxes. However, there are two problems with this interpretation. First, it is too narrow a concern to be explained by a belief in pooling. A pooling justification would mention not only equal-income couples under different marital property regimes; it would also mention equal-income couples under the same separate property regime, but with different income splits between the spouses. Second, the concern expressed in the Senate Report is really that husbands (rather than couples) with equal income pay equal tax, regardless of their state of residence.

After 1948, tax scholars sought a more compelling justification for joint returns than the accident of Poe v. Seaborn, and developed theories based on pooling.\textsuperscript{32} At best, however, these are after-the-fact justifications for what Congress had done, not explanations for why Congress had done it.\textsuperscript{33}

\textsuperscript{32} See supra note 13.

\textsuperscript{33} As one churlish but accurate commentator noted,
Nor is there any evidence that Congress later realized the tax significance of marital pooling and retained joint returns for that reason. If Congress had converted to a belief in joint taxation based on pooling, it would have adopted joint marital taxation for purposes of the social security wage tax as well. However, that tax has always treated spouses as separate taxpayers.  

It is possible, of course, that the joint spousal return is a lovely child, despite its accidental conception. The strange story of its beginnings, although suggestive of its merits, is not dispositive. It is still necessary to consider the evidence concerning marital pooling and its relevance to tax policy.

B. Do Spouses Pool Their Income?

There has been remarkably little empirical research into the income-sharing patterns of married couples. Indeed, a leading scholarly defense of joint returns took it as self-evident that "married couples should be assumed to share their income equally," and cited no supporting research. In a recent provocative critique of the marital pooling assumption, Marjorie Kornhauser surveys the literature and reports only one substantial study of marital pooling in the United States, by Philip Blumstein and Pepper Schwartz. Faced with this paucity of information, Kornhauser also conducted her own survey on marital-pooling attitudes and practices using a ninety-three-question [A] happenstance has been elevated to the level of a principle . . . . Because tax philosophers have to have a fundamental explanation for why the Internal Revenue Code looks the way it does, they discovered the principle that no one knew existed before 1948, namely, that the income of married couples should be aggregated; and we have had disequilibrium ever since.

Alfred B. Fit, The Visigoths and the Marriage Penalty, 8 TAX NOTES 834 (1979) (letter to the editor).

34. The social security tax is discussed infra notes 101-06 and accompanying text.
survey distributed to two groups: randomly chosen households in the Cleveland area and students at Cleveland-Marshall College of Law.38

An investigation of marital pooling can focus on either spousal attitudes and beliefs about pooling or actual behavior. Blumstein and Schwartz, in their survey of over 3600 married couples, concentrated on attitudes towards marital pooling of financial resources.39 They found that among wives 69% favored pooling, 19% were neutral, and 12% were opposed.40 Among husbands 75% favored pooling, 17% were neutral, and 8% opposed.41 Favorable attitudes towards pooling were positively associated with the duration of the marriage, but even among persons married less than two years, 63% of wives and 67% of husbands favored pooling.42 Blumstein and Schwartz also surveyed unmarried heterosexual couples, and found much less support for pooling. Only 27% of female cohabitators favored pooling (29% were neutral and 44% opposed), as did only 32% of male cohabitators (with 31% neutral and 37% opposed).43 With gay and lesbian couples, attitudes towards pooling were strongly associated with the length of the relationship. Only 31% of lesbians together for less than two years favored pooling, but that increased to 40% in relationships of two to ten years, and 59% in relationships of more than ten years.44 For gay men the equivalent figures were 35%, 44%, and 68%.45

Kornhauser considers the narrow focus on attitudes to be a major limitation of the Blumstein and Schwartz study,46 but attitudes towards pooling should be more important than behavior in deciding whether married couples should be taxed as economic units. The income tax treatment of marriage must be consonant with widely held views of the nature of marriage.47 If couples believe in the principle of marital pooling, they will take seriously a justification for joint returns based on pooling—even if a study of their behavior might find

38. Kornhauser, supra note 36, at 84. She received 83 completed surveys from the first group and 179 from the second, constituting a response rate of 17% for each group.
39. Blumstein & Schwartz, supra note 37, at 549 n.12. Their data was collected from 1978 to 1981.
40. Id. at 101.
41. Id.
42. Id.
43. Id.
44. Id.
45. Id. at 95.
46. Kornhauser, supra note 36, at 86 n.64.
47. Stanley S. Surrey, Family Income and Federal Taxation, 24 Taxes 980 (1946) ("Any solutions in the field of family income . . . must meet the test of learned debate in millions of homes and social gatherings.").
that they pool resources less than they think they do (or think they should).

Not only are attitudes to pooling more important for tax policy than pooling behavior, they are also considerably easier to determine. It is extremely difficult to gather reliable information on pooling behavior, partly because of the great mass of relevant behavior, partly because of privacy concerns, and partly because of the difficulty of interpreting behavior. Kornhauser acknowledges these difficulties in detail and with considerable sensitivity.48 Having done so, she nevertheless places special emphasis on her findings concerning whether couples deposit their earned income into joint or separate accounts49—which happens to be a good example of the difficulty of interpreting behavior. The use of separate accounts may indicate a real rejection of pooling, or it may be a mere bookkeeping convenience—with the couple combining resources but dividing the check-writing duties.50 Similarly, the way in which legal title to assets is held (jointly or separately) may or may not coincide with how the couple thinks of those assets,51 and it is a matter of debate to what extent pooling has occurred when consumption is joint but control and enjoyment are not (for example, a joint vacation to a place one spouse likes and the other does not).52 Another ambiguous behavior is a couple sharing household expenses in proportion to their incomes.53 Such couples have made some effort to keep their finances separate, but the principle of “from each according to ability” would hardly be adopted by mere housemates.

For whatever it may be worth, Kornhauser reports that 70% of the married respondents in her random survey, and 55.6% of married and cohabiting respondents in her law student survey, indicated they deposited earned income solely in joint accounts.54 She is unimpressed with the prevalence of pooling based on this data, as indicated

48. Kornhauser, supra note 36, at 80-84.
49. Id. at 85.
50. Kornhauser also notes this point. Id. at 82.
51. Id.
52. Kornhauser offers a similar example involving ice cream. Id. at 83 n.55. The tax significance of control over income is discussed infra part II.C.
53. Rosanna Hertz reports this as a common pattern among the dual career couples she studied. Hertz, supra note 37, at 90-91.
54. Kornhauser, supra note 36, at 86. A striking piece of anecdotal evidence of the use of separate accounts comes from Ellen E. Schultz, How to Split the Tax Bill with Your Spouse, WALL ST. J., Mar. 31, 1993, at Cl. The story reports that increasing numbers of two-earner couples are asking their tax return preparers to calculate each spouse’s share of their joint-return
by her references to "only seventy percent" and "a mere 55.6 per-
cent."\textsuperscript{55} I find the data more impressive, for several reasons. First, it
is easier to think of separate accounts as shared marital property (kept
separate only as an accounting convenience) than it is to think of joint
accounts as separate property. Thus, the percentage of spouses who
share resources should be higher than the percentage who use joint
accounts. Second, many of the spouses who do not use joint accounts
exclusively use a combination of joint and separate accounts (in the
random survey 21\% used a combination and 9\% used only separate
accounts; in the law student survey 17\% used a combination, and 27\%
kept all earnings separate).\textsuperscript{56} Finally, the higher joint account per-
centage for the random survey is the more relevant, both because it
includes only married couples\textsuperscript{57} and because it is more representative
of the general population.\textsuperscript{58} Far from indicating the weakness of the
pooling assumption, Kornhauser's data (from the far more relevant
random survey of married persons only) indicates that only 9\% of
couples deposit none of their earnings in joint accounts—and even
among that 9\%, the use of separate accounts does not necessarily
negate pooling.

Another way of examining pooling behavior is from the Bureau
of Labor Statistics data on household income and expenditures.\textsuperscript{59}
This data strongly suggests that the vast majority of households spend
the vast majority of their income in ways which would make it difficult
or impossible not to pool the consumption of the income. Income
spent on housing is necessarily shared by spouses living in the same
house. Consumption of food is not literally shared, but it is likely that
spouses will share a general standard of eating. The same is true of
the other major expenditure areas of clothing, transportation (which is
literally shared in some cases) and health care. Different consumption

\textsuperscript{55} Kornhauser, supra note 36, at 86.
\textsuperscript{56} Id. at 86-87 nn.65-66.
\textsuperscript{57} Blumstein & Schwartz, supra note 37, at 101. Unmarried couples, who were
included in the law student survey, are much less likely to believe in pooling.
\textsuperscript{58} Kornhauser claims that the law student survey "of a younger population more ac-
curately reflects present and future trends." Kornhauser, supra note 36, at 87. I do not share her
confidence that in a decade or two the entire nation will behave as law students do now.
\textsuperscript{59} Bureau of the Census, U.S. DEPT OF COMMERCE, STATISTICAL ABSTRACT OF THE
UNITED STATES 1992, Table 692 (112th ed. 1992) (Average Annual Income and Expenditures of
All Consumer Units: 1990).
standards in these areas are possible, but not likely. A high income husband may spend thousands on a sports car, expensive suits, and separate vacations, while relegating his non-earner wife to an old compact, sweat shirts, and a weekend with her mother, but this is hardly the norm.

The lowest income quintile of households\textsuperscript{60} averaged (for 1990) $5,554 in after-tax income, and $12,908 in consumption expenditures.\textsuperscript{61} Housing costs ($4,440) and food costs ($2,401) combined exceeded income.\textsuperscript{62} There is no significant opportunity for couples in this income group not to pool their consumption. The second lowest quintile has only slightly more opportunity. Its average after-tax income is $13,429, and its average expenditures total $17,924 (including $14,598 for food, housing, clothing, transportation and health care).\textsuperscript{63} The middle quintile has after-tax income of $22,678 and total expenditures of $24,673 (including $18,829 for the five categories listed above).\textsuperscript{64} There is some opportunity for separate consumption here, but it is quite modest. The fourth quintile manages to spend slightly less than its income: $35,050 after-tax income versus $34,247 total expenditures ($25,147 for the five categories).\textsuperscript{65} Even among this relatively affluent group, the five basic consumption categories absorb nearly 70\% of after-tax income, and there is no significant unconsumed income available for savings (whether separate or pooled). The top quintile averages $67,835 income after taxes, and spends a total of $55,411 (including $38,841 for the five categories).\textsuperscript{66} This group does have significant opportunity for unshared consumption and separate savings, but even here a majority of after-tax income is consumed in the five categories in which sharing is the norm. Even for this top income group, saved income is only about 20\% of total after-tax income. Moreover, the opportunity for truly separate savings is severely limited by the fact that in most states such savings will

\begin{footnotesize}
60. The data summarized here is for all households, whether married or unmarried. Unfortunately, the data for "husband and wife consumer units" are not broken down by income groups.
61. \textit{Bureau of the Census, supra} note 59, Table 692.
62. \textit{Id.}
63. \textit{Id.}
64. \textit{Id.}
65. \textit{Id.}
66. \textit{Id.}
\end{footnotesize}
be subject to equitable distribution upon divorce, regardless of legal title. 67

Quite apart from what surveyed spouses may say they believe about pooling, or how they may say they behave, these patterns of household income and expenditure indicate that most spouses have no choice but to share roughly equally in the consumption of their combined income. 68

It might be nice if there were more studies of marital pooling beliefs and practices, but whether the focus is on attitudes, reported behavior, or income and expenditure patterns, the evidence of pooled marital income consumption is quite strong. Kornhauser criticizes the assumption—built into the Internal Revenue Code—that all married couples pool and all unmarried persons do not as both over- and under-inclusive. 69 She is right, of course, that not every married couple shares its income and not every single person lives in financial isolation. No bright-line test is perfect, but this particular test is actually quite good. If one accepts the premise that the crucial question in determining the appropriate taxable unit is “Does this person pool his income with another person for the purpose of shared consumption (and savings)?” then requiring joint returns for married couples and separate returns for unmarried persons is an easy-to-administer rule that gets it right most of the time. 70 Kornhauser fails to note that her preferred approach of separate returns for all married couples would

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68. McIntyre makes the same point, but he does so by relying on his own guess about income and expenditure patterns, rather than any real data. Michael J. McIntyre, Taxation of the Family: Economic Mutuality and the Need for Joint Filing, 1 CAN. TAX. 14, 14-15 (1979). Dulude properly takes him to task for that. Dulude, supra note 37, at 90. The discussion in the text demonstrates, however, that McIntyre’s instincts were right even if his method was less than rigorous.

69. Kornhauser, supra note 36, at 86, 105.

70. Lenore Weitzman presents strong evidence that pooling generally does not continue after divorce. Lenore J. Weitzman, The Divorce Revolution: The Unexpected Social and Economic Consequences of Women and Children in America (1985). Homemaker-wives typically receive little or no interest in their spouses’ future earnings potential through either property settlement or alimony, despite their detrimental reliance on the pooling ideal. This does not, however, weaken the evidence of pooling during marriage, nor does it support the argument that the tax system should ignore pooling during marriage. The fact that pooling may not continue forever is not a reason to ignore it while it exists. If pooling continues post-marriage the tax system will account for it through the treatment of alimony, I.R.C. §§ 71, 215 (West Supp. 1993); if it does not continue, the tax system will not treat the income as shared. (If the system taxed the accretion of human capital during marriage, the tendency of the individual with the capital to capture it all at divorce would give rise to a strong argument that the income
be much more under-inclusive (because most spouses do pool) than joint returns are over-inclusive.\textsuperscript{71}

C. Shared Consumption or Shared Control?

Given the need for a workable bright-line test, joint returns for married couples (and only for married couples) is the right answer—if the existence of shared consumption is the right question. But is that the right question? Proponents of joint returns say it is. Michael J. McIntyre, for example, claims that "the question to be decided is whether marital partners share the benefits of income. Control over income . . . should be relevant only in a tax system that makes control over income the measure of taxable capacity."\textsuperscript{72} This is a strange remark, given that the federal income tax ordinarily does make control over income, rather than benefit from income, the test of taxability.\textsuperscript{73} It is, after all, basically an income tax, rather than a consumption tax. That is, the tax base (subject to important exceptions) is not just consumed income, but income whether consumed or saved.\textsuperscript{74} Under an income tax, it would seem more sensible to consider the joint-return question from the perspective of whether couples share control over income, than it would be to examine whether they share consumption.

\textsuperscript{71} The theoretical solution for the under-inclusiveness of joint returns would be to require persons who are not married, but who pool their income, to file joint returns. Kornhauser concludes that this would be unworkable, and I agree. Kornhauser, \textit{supra} note 36, at 71-72, 107. The resulting under-inclusiveness is not severe, at least if attitude toward pooling is considered the crucial issue. Blumstein and Schwartz found that less than a third of unmarried heterosexual couples favored pooling. See BLUMSTEIN & SCHWARTZ, \textit{supra} note 37, at 101. For gay and lesbian couples, they found majority support for pooling only among relationships more than ten years old. \textit{Id.} at 95.

\textsuperscript{72} Michael J. McIntyre, \textit{Tax Justice for Family Members After New York State Reform}, 51 Ala. L. Rev. 789, 792-3 n.17 (1987). This is consistent with the "benefit rule" advocated by McIntyre and Oldman, \textit{supra} note 13, at 1575-79.

\textsuperscript{73} Pamela B. Gann, \textit{Abandoning Marital Status as a Factor in Allocating Income Tax Burdens}, 59 Tex. L. Rev. 1, 25 (1980); Kornhauser, \textit{supra} note 36, at 102-03 n.125.

Except for joint returns, the federal income tax does determine tax liability according to who controls income, by earning it or by owning the income-producing property. This is the lesson of Lucas v. Earl itself, which remains fundamental law outside of the joint-return context. An important application of this rule is the income tax treatment of gifts and bequests as neither taxable to the donee nor deductible by the donor. This treatment separates the income tax liability on the income used to acquire the gifted property (which was imposed on the donor, and which is not shifted by the gift) from the ability to consume (which was transferred to the donee).

Even within the nuclear family, consumption is not treated as the test for taxability except for married couples. If shared consumption and a shared standard of living were the key, the taxable unit would be the entire family, including minor children. Except for substantial amounts of unearned income of children under age fourteen, however, the income of children is not aggregated with parental income by the income tax. In keeping with this focus on control rather than consumption, amounts spent to support a child are not deductible by the parent and not taxable to the child.

There is considerable evidence that control over marital income—the power to decide how the income shall be used—is much less shared than the consumption of the income. The spouse who earns the income tends to retain control over how the money is used, even if that spouse's decision results in shared consumption.

75. 281 U.S. 111 (1930). The analogous case with respect to income from property is Helvering v. Horst, 311 U.S. 112 (1940).
77. I.R.C. § 1(g) (West Supp. 1993), the "kiddie tax," taxes the unearned income of a child under 14, in excess of $1,000 (adjusted for inflation), at the parents' marginal tax rate. For a proposal to treat the family as the taxable unit, see Martin J. McMahon, Jr., Expanding the Taxable Unit: The Aggregation of the Income of Children and Parents, 56 N.Y.U. L. Rev. 60 (1981). Family unit taxation has long been used in France. The French system is described in Dulude, supra note 35, at 71-73.
78. However, McIntyre & Oldman, supra note 13, at 1607, suggest that dependency exemptions can be viewed as allocating a portion of family income to children, based on their assumed consumption, and then taxing that income at a zero rate.
80. A non-earning spouse may often manage the couple's finances, but this is usually a ministerial position with no decision-making authority. PAUL, supra note 37, at 49-56, cited in Kornhauser, supra note 36, at 83 n.56.
Sociological exchange theory posits that a husband in a traditional marriage receives full value for his earnings in the form of non-monetary benefits from his wife. This value may include the household and child care services usually featured in discussions of imputed income from services, but it may also include things not normally considered in relation to imputed income such as emotional support, sexual intimacy, and enhanced status (the “trophy wife”). A 1981 note in the Yale Law Journal argues that allowing an earning husband to split his income with his non-earning wife (on a joint return) is inappropriate, because exchange theory establishes that the husband has been able to retain the benefit of all his income. Actually, this argument suggests that the husband should be taxed on all his earnings regardless of whether the test is control or consumption. The note does not quite have the courage of its conviction, because it shies away from the logical conclusion of the analysis: that the husband should be taxed on all his income, and that the wife should be taxed on the portion of his income he uses to “buy” services and other benefits from the wife. Thus, under this analysis some portion of the husband’s income should be taxed twice.

Despite the evidence that consumption decisions are much less shared than the consumption itself, the point may be too controversial with the general public to serve as a basis for tax policy. And exchange theory is an even more problematic foundation for the taxation of husbands and wives. It is not necessary, however, to reach any decision about either the distribution of marital decision-making

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81. The foundational works in exchange theory are Peter M. Blau, Exchange and Power in Social Life (1964), and George Caspar Homans, Social Behavior: Its Elementary Forms (1961). The literature of marital exchange theory is reviewed in Note, supra note 79, at 373-76.
82. Imputed income from services is discussed infra text accompanying notes 165-81.
83. Note, supra note 79, at 376-78.
84. The husband should get no deduction for his “payment” to his wife, because it is used to purchase personal consumption. I.R.C. § 262 (West Supp. 1993). Some portion of the payment, however, might qualify for the child care credit of I.R.C. § 21 (West Supp. 1993).
85. The Note mentions and rejects the possibility of double taxation, but offers no satisfactory explanation for the rejection. Note, supra note 79, at 377 n.57. It suggests that the wife should have no tax liability because her services normally produce tax-free imputed income, and so such services “should not be recognized as sources of income when a lesser-earning spouse provides them in exchange for cash income earned by the greater-earning spouse.” Id. at 378. This ignores the crucial fact that imputed income requires the absence of an exchange; when services are performed in exchange for benefits from another (especially cash), the resulting income is not tax-free imputed income.
86. It would be easy to caricature exchange theory as holding that a traditional marriage is nearly indistinguishable from prostitution. I am reminded of a George Booth cartoon in which a preacher is being chased out of church by an angry mob of a congregation. The reader board
power or about exchange theory in order to apply basic income tax principles to the taxation of spouses. The basic principles are very simple. Earned income is taxed to the earner, and property income is taxed to the owner. The law normally looks no further into questions of power than that, and reasonably so. Earners always have a closer connection to their earnings than anyone else can possibly have. They always have ultimate control, because they can always determine whether or how much to work. Similarly, owners of wealth can always determine how to employ that wealth. Even if earners or owners cede some control over the consumption of their income by marrying, they still have control over the source of the income (as well as control over whether to remain married).

If, then, the focus is on consumption of income, a joint-return system is appropriate. If the focus is on control, separate returns are called for. The choice of focus depends on whether consumption or control is a better measure of ability to pay. Ability to pay is crucial because the choice of a taxable unit matters only under a progressive tax system, and progressivity is based on the premise that ability to pay increases more than proportionately with income.

It is arguable whether the income one controls or the amount one consumes is a better measure of one's ability to pay. This question has been much debated between proponents of an income tax and proponents of a consumption tax. Unlike an income tax, a consumption tax would not tax saved income. Alvin Warren has noted that plausible cases can be made both for measuring ability to pay taxes by one's

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gives the title of the sermon: "Are We All Prostitutes?" GEORGE BOOTH, THINK GOOD THOUGHTS ABOUT A PUSSYCAT (unpaginated, 1975).

87. See supra note 3.

88. The classic examination of the justifications for progressive taxation is Walter J. Blum & Harry Kalven, Jr., The Uneasy Case for Progressive Taxation, 19 U. CHI. L. REV. 417 (1952). Blum and Kalven conclude, "It is hard to gain much comfort from the special arguments, however intricate their formulations, constructed on notions of benefit, sacrifice, ability to pay, or economic stability. The case has stronger appeal when progressive taxation is viewed as a means of reducing economic inequalities." Id. at 519-20. I suspect that much of the appeal of progressive taxation stems from widespread belief in the declining marginal utility of money, despite the impossibility of interpersonal comparisons of the utility of money. For a feminist defense of progressivity, see Marjorie E. Kornhauser, The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction, 86 MICH. L. REV. 465 (1987).

share of the product of society’s output (income tax) and for measuring ability to pay by one’s standard of living (consumption tax).90 He also notes, however, that “the strongest argument in favor of income taxation as opposed to consumption taxation as a matter of fairness is that only income taxation reaches wealth or the return to wealth.”91 The fact that Congress has adopted an income tax rather than a consumption tax suggests that Congress believes the income one controls is a fairer measure of ability to pay than what one consumes. Separate returns are consistent with a system that determines ability to pay by the income one controls; joint returns are not.

An advocate of joint returns might respond that the issue in the choice between an income tax and a consumption tax is the taxation of saved income, while the issue in the choice between joint and separate returns is quite different: whether the earner or the consumer should be taxed on earned income. Despite this difference, both issues involve whether it is fairer to tax a person on the income the person controls or the income the person consumes. Only separate returns are consistent with the ability-to-pay approach reflected in the choice of an income tax rather than a consumption tax.

Having said this, I must concede that basing spouses’ abilities to pay on consumption is neither unreasonable in theory, nor entirely inconsistent with the nature of the existing income tax system (because of the system’s significant consumption tax features).92 Either consumption or control is a plausible measure of ability to pay. I find a focus on control more attractive, but the question is too close for me to be comfortable with resolving the taxation of marriage on this basis alone. Perhaps the proponents of joint returns can offer some convincing reason why the control principle should not determine the taxation of spouses.

D. REFEREEING THE BATTLE OF THE NEUTRALITIES

One reason for the control principle not determining marital taxation could be the popular appeal of the principle of equal taxes for equal-income couples. If people generally think of couples as economic units, the perceived fairness of taxing equal-income couples equally—regardless of how marital income is distributed among the

91. Id. at 1122.
92. Those features are discussed supra note 74.
spouses—might overwhelm any objection to joint returns based on violation of the control principle. But this is too narrow a view of the problem. The question is not simply whether people think equal taxation of equal-income couples is desirable, but whether it is a more important equity concern than the incompatible goal of marriage neutrality. The question comes down to whether people would be more offended by equal combined-income couples paying different amounts of tax (the non-neutrality of separate returns), or by marriage penalties and marriage bonuses (the non-neutrality of joint returns).

There is clearly considerable unhappiness with the current system. Approximately 70% of the respondents to a Harris poll favored eliminating the marriage penalty on two-earner couples.93 A recent search in the NEXIS Omni file found over 1,000 references to the "marriage penalty."94 The media have thoroughly reported on the increased marriage penalties that will occur under the 1993 tax legislation.95 In a few well publicized cases, people have been unhappy enough to try to avoid the marriage penalty by repeated December divorces and January remarriages.96

It might be objected that since we do not have a separate-return system, we cannot know how strong the popular objections would be to such a system. That is not entirely true, however, for three reasons.

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93. Harris Surveys, Study Number 812104 (March 1981) (reporting that 71.3% favored eliminating the penalty, 26.2% opposed, and 2.5% uncertain); Harris Surveys, Study Number 812106 (May 1981) (reporting that 69.5% favored eliminating the penalty, 28.1% opposed, and 2.4% uncertain). Despite considerable research in the major public opinion surveys, these were the only questions on the marriage penalty I was able to find.

94. The Omni file covers a broad selection of the popular press over the 1980s and 1990s. The search was conducted on June 23, 1993, and found 1,092 items. It is possible that a few of the items referred to non-tax marriage penalties, but a search for "marriage penalty" within 20 words of "tax" found 939 items. Interestingly, references to the singles penalty (189 references, of which only 15 were within 20 words of "tax") and to the marriage bonus (32 references) were much less common. The magnitude of this difference is not explained by the relative impacts of penalties and bonuses. Harvey S. Rosen has estimated that, in 1988, 40% of couples paid an average marriage penalty of $1,100 (for a total of $24 billion) and 53% of couples received an average marriage bonus of $609 (totalling $17.4 billion). Harvey S. Rosen, The Marriage Tax Is Down But Not Out, 40 Nat’l Tax J. 567, 574 (1987). The difference in complaint volumes suggests the possibility of retaining joint filing, but designing the rate structures to produce only marriage bonuses. History counsels against that, however. The system of marriage bonuses only, in effect from 1948 to 1969, produced resentment leading to modification of the system in 1969. Bittker, supra note 12, at 1428-29.

95. See sources cited supra note 11.

96. Perhaps the best known of these "part-time" couples are David and Angela Boyter. Their divorce-remarriage is the subject of Boyter v. Commissioner, 668 F.2d 1382 (4th Cir. 1981) (holding that the sham transaction doctrine could apply to a divorce-remarriage, and remanding to the Tax Court for a determination of whether the doctrine should apply in the Boyters’ case).
First, there is the pre-1948 experience with an income tax based on separate returns. The only equity-based complaints with that system concerned the geographic discrimination created by *Poe v. Seaborn* in the taxation of the earnings of *husbands.* There is no indication of any objection to the unequal taxation of one-earner and two-earner couples with equal combined incomes.\(^7\) Second, there is the more recent experience with the two-earner deduction. From 1981 to 1986 the law allowed a deduction of 10% of the earned income of the lower earning spouse (with the deduction not to exceed $3,000).\(^8\) The deduction alleviated, but did not eliminate, the marriage penalty. In so doing, the deduction violated the principle of equal tax on equal income couples. A two-earner couple with two $30,000 earned incomes would have $3,000 less taxable income than a $60,000 one-earner couple.\(^9\) There was no resulting outcry from angry single-earner couples. When the deduction was repealed in 1986, the official explanation was that the reduced progressivity of the rate schedules reduced marriage penalties to the point where additional relief was not needed.\(^10\) Discrimination against one-earner couples was not cited as a reason for change.

Finally, and most significantly, there has been no public outcry against the separate taxation of spouses under the social security wage tax.\(^11\) Under this tax each person, regardless of marital status, pays tax at a flat rate of 7.65% on the first $57,600 earnings.\(^12\) This means

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\(^7\) Nor can the absence of objections be explained by the scarcity of working wives in the 1940s. The labor force participation rate of wives in 1940 was 14.7%, and in 1950 was 23.8%. *Tax Treatment of Married, Head of Household, and Single Taxpayers: Hearings Before the House Comm. on Ways and Means, 96th Cong., 2d Sess. 19 (1980) (statement of Emil M. Sunley, Deputy Asst Sec'y of the Treasury, based on U.S. Bureau of Labor Statistics).*

\(^8\) I.R.C. § 221 (repealed 1986).

\(^9\) Because taxes were still determined on a joint-return basis, from 1981 to 1986 the tax system violated both couples neutrality and marriage neutrality.


\(^11\) In 1991, social security tax revenues were $396 billion, which is about 85% of 1991 personal income tax revenues of $467.8 billion. *Office of Management and Budget, Budget of the United States Government, Fiscal Year 1993,* pt. 2, at 3 (1992). McCaffery points out that, under the assumption that employees bear the burden of the employer's share of social security tax, "social security taxes also represent a greater burden than the federal income tax does on all but the highest-earning Americans." McCaffery, *supra* note 15, at 997.

\(^12\) More precisely, there is a 6.2% wage tax imposed by I.R.C. § 3101(a) (West Supp. 1993), and an additional 1.45% hospital insurance wage tax imposed by I.R.C. § 3101(b)(6) (West Supp. 1993). (The matching employer's taxes are imposed by I.R.C. § 3111 (West Supp. 1993).) For 1993, the 6.2% tax applies to the first $57,600 of wages, and the 1.45% tax applies to the first $135,000. Notice of the Secretary of Health and Human Services, 57 Fed. Reg. 48,619 (1992). Beginning in 1994, the $135,000 ceiling is repealed, and all earnings are subject to the
that a two-earner couple may pay much more social security tax than an equal-income one-earner couple. For example, two spouses who earn $55,000 each will pay almost twice as much as a $110,000 single-earner couple.\textsuperscript{103} This separate-taxpayer system is not an administrative necessity.\textsuperscript{104} Nor is it explicable on the grounds that the social security tax has some features of a retirement savings plan, rather than a pure tax, because marital status is relevant in determining eligibility for retirement benefits.\textsuperscript{105} Thus, the relationship to benefits suggests the couple should be the taxable unit.

I am aware of no popular outcry whatsoever against the unfairness of what might be called the two-earner penalty of the social security tax.\textsuperscript{106} A NEXIS search of the Omni file for such complaints found nothing. The search was hampered by the absence of a term in common usage, analogous to marriage penalty, to describe the effect of the social security tax on two-earner couples. "Two-earner penalty" would be the obvious term, but it does not appear in the Omni file. Of course, the absence of such a term is itself revealing: If there is no term in popular usage to describe this penalty, it must be because there is no popular objection to the penalty.

I can only speculate why the non-neutrality inherent in joint returns (marriage penalties and bonuses) bothers people so much more than the non-neutrality inherent in separate returns (different taxes on equal-income couples), but I do have some ideas. First, I

\textsuperscript{103} The effects of the social security tax on two-earner couples are discussed by McCaffery, \textit{supra} note 15, at 996-1001. Notice the paradox that two-earner couples are penalized both by the joint-return income tax system, and by the separate-taxpayer social security tax system. This occurs because the income tax is progressive and the social security tax is regressive.

\textsuperscript{104} A person with more than one employer during a year who has social security taxes withheld on more than the maximum salary amount may claim an income tax credit or refund. \textit{DEPARTMENT OF THE TREASURY, INTERNAL REVENUE SERVICE FORM} 1040, at line 58 (1992); \textit{id.} at 26. The same system could be used if spouses were treated as the social security taxable unit.

\textsuperscript{105} A married woman who has paid no social security tax of her own is entitled to benefits calculated on half of her husband's average earnings. 42 U.S.C. \textsection{} 416 (1988). A married woman who has made contributions of her own must choose between her spousal benefits and the benefits based on her own contributions. In many cases the spousal benefits will be greater, so she will get no return on her own contributions. The benefits structure is described in greater detail by McCaffery, \textit{supra} note 15, at 999.

\textsuperscript{106} McCaffery criticizes the system's treatment of second earners, but his concern is with the behavioral effects of the system rather than with its neutrality, and he does not propose joint taxation of spouses as a solution. McCaffery, \textit{supra} note 15, at 996-1001. In any event, a law review article does not qualify as a popular outcry.
suspect that people find marriage neutrality the more compelling of the two principles. They simply believe that it is more important for the tax system not to encourage or discourage marriage (especially the latter) than it is for equal-income couples to pay equal taxes. Second, I think people are more aware of marriage penalties and bonuses than they are of whether equal-income couples are paying equal taxes. Marriage penalties and bonuses can be determined without reference to any other taxpayers. When you get married (or contemplate marriage), you see the penalty (or bonus) without the need to compare yourself to anyone else; so too when you get divorced or contemplate divorce. For that matter, it is simple enough to calculate every year how much more or less you would pay if you were not married. By contrast, you have to think about other taxpayers in order to be bothered by the non-neutrality inherent in separate filing, and people are less likely to do that.

There may be another reason why victims of the marriage penalty do not accept the explanation of the need to impose equal tax on equal-income couples (couples neutrality). They may realize that the couples neutrality justification fails even on its own terms, because one- and two-earner couples with equal taxable income are generally not equal in taxpaying ability. The one-earner couple is significantly better off because of its greater imputed income from self-performed services and its lesser nondeductible work-related expenses (such as for clothing and commuting).\textsuperscript{107} Defenders of the joint-return system, when considering this argument, typically respond that the problems caused by differences in amounts of imputed income and nondeductible mixed business-personal expenses are not limited to one-earner versus two-earner couples. Thus these problems should either be

\begin{flushright}
\textsuperscript{107} McIntyre & Oldman, \textit{supra} note 13, at 1614-18, question whether one-earner families really have greater imputed income. Despite their doubts, the pattern of greater imputed income in one-earner families has been well established by empirical studies. Studies have consistently found that employed wives spend substantially less time on housework than unemployed wives, and that husbands of employed wives do not do significantly more housework than husbands of unemployed wives. \textit{Barbara R. Bergmann, The Economic Emergence of Women} 261-66 (1986); \textit{Blumstein & Schwartz, supra} note 37, at 144-46. In addition to studying time spent on housework, differences in imputed income can be approached indirectly, by studying differences in expenditure patterns of one- and two-earner families. Many expenditures by two-earner families may represent items that would be imputed income in a one-earner family. Examples include expenditures for child care, house cleaning, laundry, and convenience foods. The evidence is strong that two-earner families incur substantially greater expenditures of these sorts. See \textit{Sandra L. Hanson & Theodora Ooms, The Economic Costs and Rewards of Two-Earner, Two-Parent Families}, \textit{53 J. MARRIAGE & FAM.} 622 (1991) (based on an analysis of data from the National Consumer Expenditure Survey). \end{flushright}
ignored for all taxpayers or addressed for all taxpayers.\textsuperscript{108} A response to these problems limited to working wives would be too narrow.\textsuperscript{109} Edward J. McCaffery powerfully argues that a response to these problems limited to two-earner couples may not be inappropriate, because the behavioral effects of the problems on wives are especially severe.\textsuperscript{110} The tax treatment of imputed income and nondeductible work-related expenses encourages wives not to enter the labor force, thereby perpetuating gender role stereotypes and the economic dependence of women. But one need not be willing to go as far as McCaffery in order to see imputed income and mixed expenses as relevant to the joint-return controversy. Even if one questions using imputed income and mixed expenses \textit{affirmatively} to justify special tax allowances for working wives, one may still invoke them \textit{negatively} to undercut the argument that joint returns achieve neutrality among equal-income couples.

Stanley Surrey wrote in 1946, "Any solutions in the field of family income . . . must meet the test of learned debate in millions of homes and social gatherings."\textsuperscript{111} The choice between the dueling neutralities in the taxation of marriage must meet the test of public opinion. The conclusion is inescapable that the public accepts the lack of couples neutrality in the separate-tax system of social security, far better than it accepts the lack of marriage neutrality in the income tax.

\section*{III. THE BEHAVIORAL EFFECTS OF JOINT RETURNS}

The discussion thus far has concentrated on equity concerns—whether separate returns would be fairer than joint returns. It turns now to behavioral concerns—whether the joint-return system inappropriately encourages or discourages certain behaviors. If, for example, the system taxes a two-earner married couple more heavily than two single persons with the same incomes, the issue is fairness. If the greater tax burden causes a two-earner couple not to marry (or to obtain a divorce), the issue is behavioral effects. McCaffery criticizes most of the literature on the taxation of spouses for its "focus on static, distributive concerns of what groups pay how much tax," rather

\textsuperscript{108} Bittker, \textit{supra} note 12, at 1435.

\textsuperscript{109} An example would be the two-earner deduction, if it is viewed as a response to these problems, rather than as a response to the marriage penalty. For this view of the two-earner couple, see McCaffery, \textit{supra} note 15, at 1058-59.

\textsuperscript{110} \textit{Id.} at 1009-10.

\textsuperscript{111} Surrey, \textit{supra} note 47, at 980.
than on the behavioral incentives created by the tax rules. The two major behavioral effects are on decisions whether to marry and on wives’ decisions whether to work.

A. THE DECISION TO MARRY

Since a man and woman who both work full time will usually pay more tax as a married couple than as singles, the tax laws could discourage such people from marrying (or encourage them to divorce). Although McCaffery explains in detail how the tax laws penalize marriage in certain situations, he cites no empirical evidence that significant numbers have actually been dissuaded from marriage by tax penalties. What little evidence there is of behavioral effects is anecdotal—although the anecdotes have been plentiful since the passage of the 1993 tax legislation. In the absence of good evidence, it seems likely that the behavioral effect is significant in only two situations.

First, since marital filing status for an entire year depends on whether the marriage exists as of December 31, some couples may delay a marriage from December to January for tax purposes. Even if this effect exists, it is not particularly troubling.

Second, McCaffery suggests that the behavioral effect may be significant on lower income couples, because the marriage penalty at lower income levels is especially severe, and because “legally-sanctioned marriages might be most sensitive to economic conditions” at lower income levels. The special severity is due to the phaseout of the earned income credit, which has the effect of increasing the marginal tax rate over the phaseout range. The marriage penalty created by the credit phaseout is worse than the penalty created by the basic rate structure, because the phaseout range and rate are identical for married and single persons. It is thus the equivalent of a joint filing system with the same rate schedules for marrieds and singles, which creates severe marriage penalties and no marriage bonuses.

113. It is also possible that in situations where marriage would reduce tax liability, because one person has high income and the other little or no income, the tax system may induce some marriages which would not otherwise occur. Neither McCaffery nor other commentators seem concerned about this effect.
115. See sources cited supra note 11.
119. See supra text accompanying notes 4-8.
McCaffery’s suggestion of significant behavioral effects seems plausible, although even here he cites no evidence. He acknowledges that the severity of the penalty could be alleviated, without abandoning joint returns, by redesigning the credit phaseout to give it “the degree of sensitivity to marriage that the basic rate structure has.”

Despite these two special situations, widespread effects of the tax laws on decisions to marry are unproven. The absence of proven major behavioral effects does not necessarily make marriage penalties and bonuses unobjectionable. But it does mean that the major objection must be on grounds of unfairness and inappropriate government favoritism of certain lifestyles. Equity is, of course, an important tax policy consideration. A two-earner couple that says, “We’re not going to get divorced because of the marriage penalty, but we’re mad as hell,” has a serious complaint, but the complaint is not behaviorally based.

B. Wives’ Decisions to Work

1. Work Disincentives Caused by Joint Returns

The more serious behavioral concern is the effect of the joint-return system on wives’ decisions whether to enter the labor force. If a couple views the wife as the marginal wage earner (in the sense that the husband’s job is a given, and the decision to be made is whether the wife should also take a job), then the effect of joint returns is to stack the wife’s income on top of the husband’s. This means that the first dollar of the wife’s earnings will be taxed at a high marginal rate—possibly as high as 39.6% under current law, and frequently 28% or higher. This contrasts sharply with the initial tax rates the wife would face under a separate-return system: 0% on the

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120. McCaffery, supra note 15, at 1059.
121. Strangely enough, the two favored lifestyles are radically different: traditional marriages on the one hand, and unmarried cohabitation by two-career couples on the other.
122. The following discussion isolates the work disincentive imposed by the joint return system. Additional work disincentives created by the tax laws, but not by joint returns, are discussed infra part III.B.2.
123. I.R.C. § 1(a) (West Supp. 1993). Even if the I.R.C. § 1(a) rate schedule indicates the marginal rate is 15%, the true rate will be much higher if the phaseout of the earned income credit is in effect. The phaseout is discussed infra part IV.D.3. Phaseouts function as part of the rate structure, even though their effect may not be apparent to most taxpayers.
income sheltered by her personal exemption and the standard deduction, and 15% after that.\textsuperscript{124}

Many commentators have argued that this stacking effect of joint returns inappropriately discourages women from working. McCaffery's statement of this position is the most recent, and is especially powerful. He notes the strong evidence for the high labor-supply elasticity of married women.\textsuperscript{125} That is, wives' decisions whether to work are highly sensitive to their after-tax wages\textsuperscript{126}—much more so than the work decisions of husbands and unmarried men and women. Thus the decrease in after-tax wages caused by joint return income-stacking is a significant work deterrent for married women. McCaffery criticizes this result from two perspectives.

The first perspective is that of optimal tax theory. Any tax will discourage the activity subject to tax. If the taxed activity is economically beneficial, the disincentive effect of the tax is inefficient. Optimal tax theory considers how best to limit this inefficiency—how to raise a given amount of revenue with the least possible disincentive effect. The answer is that activities should be taxed in inverse relation to their elasticities.\textsuperscript{127} The heaviest taxes should be imposed on activities least sensitive to tax. To an optimal tax theorist, the joint-return system gets things exactly backwards—the first dollars earned by hard-to-discourage husbands are taxed at low rates, and the first dollars earned by easy-to-discourage wives are taxed at high rates.

The formalist response to this criticism is that the tax laws do not distinguish between the husband's income and the wife's; nothing in the Internal Revenue Code says that the husband's income gets the benefit of the lower brackets and the wife's income is then stacked on top. If some people think of it that way, that is not the fault of the tax system, and the tax system should not be expected to respond to their misperception. In the words of Michael J. McIntyre, "If a married woman, because of a stereotyped view of marriage, views herself as the marginal worker, we might bemoan the social conventions that have encouraged that perspective, but we have no cause for complaint

\textsuperscript{124} For 1993, the personal exemption is $2,350, the standard deduction for an unmarried person is $3,700, and the 15% bracket applies to the first $22,100 of an unmarried person's taxable income. Rev. Proc. 92-102, supra note 8, §§ 2-4.

\textsuperscript{125} McCaffery, supra note 15, at 1039 n.211 (citing studies).

\textsuperscript{126} The decision to work full time rather than part time is less sensitive to wages. Id. at 1039 n.213.

\textsuperscript{127} Id. at 1037.
against the tax system."\textsuperscript{128} I think there is little room for constructive debate on this topic. Either one sympathizes with this extreme formalism, or one does not. To me, the argument shows an impressive ability to detach from reality, even for an academic. The core of the argument is that the tax laws are fine, and society had better shape up. If one believes (as I do) that the tax laws were made for society, rather than society for the tax laws, the formalist argument is not appealing.

McCaffery's second perspective is what he calls "Pigouvian taxation"—using the tax system to correct market failures.\textsuperscript{129} This is a familiar justification for the many tax expenditures contained in the Internal Revenue Code.\textsuperscript{130} The claim is that absent tax subsidies, people will not invest in the optimal amounts of, for example, owner-occupied housing,\textsuperscript{131} retirement savings,\textsuperscript{132} employer-provided health insurance,\textsuperscript{133} or depreciable business property.\textsuperscript{134} McCaffery claims that market failures are discouraging wives from working. The traditional single-earner family is the product of "the pernicious effects of entrenched patriarchy" and the result of gender bias is "a vicious cycle of unhappiness, repression, and sexism."\textsuperscript{135} Under this perspective, too, the tax laws get it exactly wrong. The joint-return system further discourages women from working, thus reinforcing the market failures, rather than correcting them.

Although McCaffery's analysis concludes that the present joint return system is especially perverse, his approach does not suggest that a separate-return system is the ideal solution. Separate returns would present working wives with the same marginal tax rates as husbands, whereas optimal tax theory would favor lower rates on wives—

\textsuperscript{128} Michael J. McIntyre, Individual Filing in the Personal Income Tax: Prolegomena to Future Discussion, 58 N.C. L. Rev. 469, 484 (1980).
\textsuperscript{129} McAffery, supra note 15, at 1046-53.
\textsuperscript{130} The concept of tax expenditures, as taxpayer-favorable provisions of the tax law designed to accomplish non-tax objectives, was developed by Stanley Surrey. See generally STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES (1973). Surrey was largely critical of the use of tax expenditures, but the practice has its defenders. See, e.g., Edward A. Zelinsky, Efficiency and Income Taxes: The Rehabilitation of Tax Incentives, 64 Tex. L. Rev. 973 (1986).
\textsuperscript{133} See generally I.R.C. § 106 (West Supp. 1993).
\textsuperscript{134} See generally I.R.C. § 168 (West Supp. 1993) (accelerated cost recovery system).
\textsuperscript{135} McAffery, supra note 15, at 1049.
perhaps even negative rates on the first dollars of earned income.\textsuperscript{136} Implementing the optimal tax approach would not necessarily involve separate returns. It could be accomplished on joint returns, using a second-earner credit or deduction.\textsuperscript{137} Even if separate returns were used to implement optimal tax policy, a taxpayer’s status as a wife would have special tax consequences: The rate schedule for wives would be more favorable than the rates for other taxpayers. Thus the system would not be marriage neutral. Under the Pigovian analysis, the current system’s reinforcement of market failure is especially bad policy, but the ideal is a tax system biased in favor of working wives (to correct non-tax discrimination against working wives), not a merely neutral system. McCaffery, then, sees a pure separate-return system as a substantial improvement over existing law\textsuperscript{138} but still decidedly “second best” when compared with the ideal.\textsuperscript{139}

My view is that, for better or worse, society is not ready to accept the tax policy implications of McCaffery’s arguments. Optimal tax theory sometimes recommends rules that, however efficient they may be, are simply incompatible with deeply held beliefs about fairness. The classic example is the optimal tax conclusion that marginal rates should be low at extremely high income levels, because the decision to work overtime to earn that second or third million dollars is easily deterred by high taxes.\textsuperscript{140} The same sort of fairness problem applies here. Special low (or even negative) rates for working wives would be perceived as unfair by one-earner couples and by single persons. The loudest complainants might be single parents who, however difficult their situations, do not have the luxury of high labor-supply elasticity (they have to work), and so do not qualify for optimal tax favoritism.

Separate returns, although not the optimal optimal tax solution, would be a great improvement over current law in optimal tax terms, and a great improvement over favoritism for wives on fairness

\textsuperscript{136} Id. at 1040. Higher rates on later dollars of wives’ earned income would be acceptable, because it is the initial decision to enter the labor force that is highly elastic. Id.

\textsuperscript{137} To achieve the desired effect, a second-earner deduction would have to be much more generous than former § 221. See supra text accompanying notes 99-100.

\textsuperscript{138} McCaffery, supra note 15, at 1041.

\textsuperscript{139} There is no a priori reason why the optimal response to the secondary-earner disincentive generated by spousal rate aggregation should be to simply ignore all marriages . . . . I want to hold out at least the theoretical possibility that tax laws can help lessen the general marginalization of women in social reality by actively assisting married women in the workforce.

\textsuperscript{140} Id. at 994 n.36.

\textsuperscript{140} Id. at 1038 n.209 (citing J.A. Mirrlees, An Exploration in the Theory of Optimum Income Taxation, 38 REV. ECON. STUD. 175 (1971)).
grounds. Separate returns would present a married woman with low marginal rates in making the initial decision to participate in the labor force; higher rates would apply when the question is whether to work more or less (rather than whether to work at all) and elasticity decreases. If this is not perfect in optimal tax terms, it is at least good. On the equity side, separate returns are not merely acceptable in terms of fairness; if my earlier analysis is right\textsuperscript{141} separate returns will be perceived as much fairer than current law (let alone a tax designed by an optimal tax proponent).

Turning to the market failure analysis, the problem is that McCaffery's market failure is another's market success. There is no societal consensus that the two-earner marriage model is better than the traditional model. It is certainly true that feminists (among others) have eloquently stated the case for the two-earner model.\textsuperscript{142} It is also true that millions of Americans have voted for the two-earner model by their actions. In 1960 only 31.9\% of married women were in the workforce, but that figure had almost doubled—to 58.5\%—by 1991.\textsuperscript{143} For the age group 25 to 34, the participation rate rose from 28.8\% to 70.1\%, and for the 35 to 44 age group from 37.2\% to 74.3\%.\textsuperscript{144} The trend has been equally dramatic for married women with children living at home. In 1975 44.9\% of married women with one or more children under eighteen were in the workforce; that figure had risen to 66.8\% by 1991.\textsuperscript{145} The corresponding figures where the youngest child is under six are 36.7\% and 59.9\%; under three, 32.7\% and 56.8\%; and under one, 30.8\% and 55.8\%.\textsuperscript{146} All these figures, however, reflect both full- and part-time workers. The percentages for full-time workers are substantially lower. In 1990, for example, only 35.5\% of married women with a youngest child under three worked full time; with the youngest child under six, 37.8\%; under fourteen, 42.6\%, and from fourteen to seventeen, 54.2\%.\textsuperscript{147}

The trend is impressive, but it has not swept all before it. One third of married women still do not work at all, and millions of those

\textsuperscript{141} See \textit{supra} part II.D.
\textsuperscript{142} An especially powerful case is made by \textit{Susan Moller Okin, Justice, Gender, and the Family} (1989).
\textsuperscript{143} \textit{Bureau of the Census, supra} note 59, Table 618.
\textsuperscript{144} \textit{Id.}
\textsuperscript{145} \textit{Id.}, Table 621.
\textsuperscript{146} \textit{Id.}
who do work do not work full time. The traditional model still commands strong support in practice, and it has forceful apologists of its own. Moreover, not all two-earner couples necessarily approve of the two-earner model. They may favor the traditional model in theory, but find it financially unobtainable.

What do we know about attitudes—as opposed to practices—towards the two marital models? There is excellent data available, because the General Social Survey of the National Opinion Research Center has tracked these attitudes over almost half a century. In 1945 only 18% approved of a wife’s working if the husband could support her. By 1969 55% approved, and by 1989 79% approved. In 1977 a slim majority disagreed with the idea that a working mother could establish as good a relationship with her children as a nonworking mother; in 1989 a substantial majority agreed. Agreement among persons from 24 to 29 rose from 60% in 1977 to 76% in 1989.

On the other hand, almost half the population still thinks that preschoolers will suffer if their mothers work. Two Gallup poll results suggest that not only is society torn by the choice between the traditional and the two-earner models; so are many individuals. When asked which kind of marriage was the more satisfying way of life, respondents preferred the two-earner model over the traditional model, 57% to 37%; but when asked which model was better for children, they favored the traditional model, 63% to 33%. A 1990 Gallup poll found that most men and women (55% of each) agreed that

148. Phyllis Schlafly is probably the most prominent proponent of the traditional model. See, e.g., PHYLLIS SCHLAFLY, THE POWER OF THE POSITIVE WOMAN (1977).
150. Id. Forty percent disapproved, and 5% did not know.
152. Id. at 530. Sixteen percent strongly agreed, 33% agreed, 34% disagreed, and 17% strongly disagreed.
153. Id. Twenty-two percent strongly agreed, 42% agreed, 29% disagreed, and 7% strongly disagreed.
154. Id. at 530. The opinions of young adults on this issue are the most significant, because they are the most likely to have young children.
155. Id. at 536. In 1989 48% thought the children would suffer, and 52% did not.
156. The first result is from GEORGE GALLUP, JR., THE GALLUP POLL: PUBLIC OPINION 1990, at 14 (1991); the second is from George Gallup, Jr. & Frank Newport, VIRTUALLY ALL ADULTS WANT CHILDREN, BUT MANY OF THE REASONS ARE INTANGIBLE, 297 GALLUP POLL MONTHLY 8, 13 (1990).
most women work only because their families need the money.\textsuperscript{157} In short, opinion polling does not establish that the two-earner model has captured the hearts and minds of the nation.

Although there have been many studies of the comparative development of children of working and homemaking mothers,\textsuperscript{158} ultimately this is a question of values, not resolvable by any amount of empirical study. Persons on different sides of the issue will not even necessarily agree on whether a particular child has or has not turned out well.

As long as society is so evenly split on such a divisive issue, the only proper stance for the tax system is one of neutrality. The current joint-return system is not neutral. It favors the traditional family both in the behavioral sense that it discourages women from working, and in the distributive sense that it ignores the fact that a one-earner couple is really better off than a two-earner couple with the same taxable income. But the kind of approach favored by McCaffery would also not be neutral; it would be designed to favor the two-earner model.

By contrast with both current law and the McCaffery approach, a system based on the simple principle of individual taxation would be perceived by both sides of the great social debate as having neither the purpose nor the effect of taking sides in the debate and so would be acceptable to both. In fact, it is the \textit{only} approach acceptable to both.

Perhaps some day a societal consensus will emerge in favor of the two-earner model. One might extrapolate that development from the long-term trend. It might also follow from consideration of the reasons behind the trend. Women may have entered the work force initially for the simple reason that their labor had risen in price until it became “in the eyes of family members, too valuable to be spent entirely in the home.”\textsuperscript{159} Having been drawn into the labor force by the lure of relatively good wages, many women found that they liked the challenge, stimulation, and psychic rewards of work;\textsuperscript{160} that they valued the greater power their income gave them within the family;\textsuperscript{161}

\textsuperscript{157} \textit{Gallup, supra} note 155, at 15.
\textsuperscript{158} Some are cited by \textit{McCaffery, supra} note 15, at 1049 n.244.
\textsuperscript{159} \textit{Bergmann, supra} note 107, at 17.
\textsuperscript{161} \textit{Blumstein & Schwartz, supra} note 37, at 139-44.
that having a job gave them greater economic security in case of divorce;\textsuperscript{162} that the extras their earnings bought came to be viewed as necessities;\textsuperscript{163} and that eventually the social pressure changed from disapproval of working women to disapproval of full-time homemakers.\textsuperscript{164} If this story is true, all the mechanisms for increased labor force participation are likely to continue to operate. If that happens, and if opinion follows practice, then there may eventually be a consensus in favor of the two-earner model.

If that happens, would the existence of that consensus then support adoption of the kind of system advocated by McCaffery? Ironically, it would not. If wives are as committed to the work force as husbands, then the optimal tax argument for special treatment disappears. And if there is no market failure, there is no need for a failure-correcting tax subsidy. Thus the McCaffery proposal is caught in a Catch-22: Until there is a societal consensus in favor of the two-earner model, tax favoritism for the model is unwarranted; once there is a consensus, tax favoritism is unnecessary.

The most important point, however, is that there is no consensus now, and in the absence of consensus a separate-return system is clearly superior to any alternative.

2. Work Disincentives Not Caused by Joint Returns

The tax laws discourage wives from entering the labor force in two important ways unrelated to the income-stacking effect of joint returns. The first is the discrimination between tax-free imputed income from services and taxable wage income. When a homemaker considers taking a job, she must take into account that she would be replacing tax-exempt imputed income with fully taxable employment income, and this will discourage her from making the change.\textsuperscript{165} This discrimination would not exist if a working wife could deduct amounts paid to another to perform the work she used to do herself. In that case, income devoted to homemaking would always be free of tax—either as imputed income or because the deduction would remove it from taxable income. Such expenses are not, however, generally deductible. Child care expenses are eligible for a credit, but for many

\begin{footnotes}
\footnote{162. This is a central message of Weitzman, supra note 70.}
\footnote{163. Hanson & Ooms, supra note 107, at 633; Bergmann, supra note 98, at 30-34.}
\footnote{164. Gerson, supra note 160, at 211-12.}
\footnote{165. Some background information on imputed income from homemaking services is supplied supra note 107.}
\end{footnotes}
taxpayers the credit falls far short of equalling the benefit of a full deduction.\textsuperscript{166} And housekeeping expenses not related to child care are not eligible for any tax benefit.\textsuperscript{167}

The second tax disincentive arises from the nondeductibility of most mixed business-personal expenses of having a job, such as commuting and the extra cost of work clothes.\textsuperscript{168} By taxing the wife on her wages, without allowing a deduction for these expenses, the system taxes her on more than her true net income from her work. This over-taxation adds more discouragement to working wives.\textsuperscript{169}

The extra expenses incurred by two-earner couples, to replace lost imputed income and for nondeductible mixed expenses, are substantial. Sandra L. Hanson and Theodora Ooms have calculated that a wife's work-related expenditures offset (on average) 68% of her earned income for wives of high income husbands, 56% for wives of middle-income husbands, and 46% for wives of low income husbands.\textsuperscript{170}

\textsuperscript{166} The credit may be of less benefit than a deduction for two reasons. First, the credit percentage may be less than the taxpayer's marginal tax rate. Taxpayers in the 28% and higher rate brackets will be eligible for only a 20\% credit. I.R.C. § 21(a)(2) (West Supp. 1993). Second, the dollar limits on the amounts creditable ($2,400 for one child and $4,800 for two or more children, I.R.C. § 21(a) (West Supp. 1993), mean some expenses will qualify for no tax benefit. An exclusion for amounts received for child care expenses under an employer's "dependent care assistance program" is provided by I.R.C. § 129, up to a ceiling of $5,000. I.R.C. § 129(a)(2)(A) (West Supp. 1993). To the extent a taxpayer is able to take advantage of this exclusion, the result is the same as allowing a deduction for child care expenses. The exclusion, however, has not been made widely available by employers. The revenue cost of the exclusion for 1993 has been estimated at only $635 million, compared with $2.955 billion for the child care credit. Office of Management and Budget, supra note 101, pt. 2, at 27.

\textsuperscript{167} Expenses for "household services" are eligible for the child care credit, I.R.C. § 21(b)(2)(A)(i) (West Supp. 1993), but only if there is a child or other "qualifying individual" in the household. I.R.C. § 21(b)(2)(B) (West Supp. 1993). This avoids the need for a tax allocation of amounts paid to a babysitter who also does some general housework.

\textsuperscript{168} Pevenser v. Commissioner, 628 F.2d 467 (5th Cir. 1980) (holding that work clothes are not deductible if suitable for general wear); Treas. Reg. § 1.162-2(e) (1986) (holding that commuting expenses are not deductible).

\textsuperscript{169} When a wife's taking a job leads to the purchase of services previously performed by the wife, the non-deductibility of the cost of those services can be viewed as this second kind of disincentive. Since it relates to imputed income, however, it is really the first type of disincentive. (The first type of disincentive could be corrected either by taxing imputed income or by allowing a deduction for the costs of replacing imputed income; thus it would be double counting to list the nontaxation of imputed income and the nondeductibility of replacement costs as two distinct disincentives). It is analytically clearer to reserve this second category for the non-deduction of mixed expenses that do not serve as replacements for imputed income—of which commuting expenses and work clothes are important examples.

\textsuperscript{170} Hanson & Ooms, supra note 107, at 631, Table 3.
These are serious problems. They are not, however, problems of joint returns. Joint returns did not create these problems\textsuperscript{171} and separate returns will not solve them. Even under a separate-return system, tax laws will discourage wives from working if they are not allowed to deduct costs of replacing imputed income and mixed business-personal expenses. If Congress desired, it could enact provisions to lessen or eliminate these disincentives—for example, a child care deduction with a high dollar-amount ceiling on eligible expenditures, or a working spouse deduction of a percentage of the second spouse's earned income (subject to a ceiling) to adjust for nondeductible mixed expenses. If appropriate at all, these provisions would be equally appropriate under either a joint-return or a separate-return regime.

The history of the now-defunct second-earner deduction of section 221\textsuperscript{172} reflects confusion concerning the relationship between joint returns and extra nondeductible expenses incurred by working wives. The deduction was for 10\% of the earned income of the lower income spouse, up to a maximum deduction of $3,000. The Joint Committee's 1981 explanation of the provision was primarily as a response to problems created by joint returns—that the deduction would alleviate the marriage penalty and lessen the high marginal rates on the second earner's income.\textsuperscript{173} But it also noted that the deduction could be viewed as an allowance for the extra expenses resulting from the wife's job.\textsuperscript{174} When Congress repealed the deduction in 1986, the Joint Committee's explanation was that it was no longer needed, because the general lowering of rates would sufficiently reduce the marriage penalty—thus implying that the deduction was intended solely as a response to problems of joint returns.\textsuperscript{175}

This emphasis on the relation of the two-earner deduction to problems created by joint returns is ironic, because the two-earner deduction actually made more sense as a response to the problem of extra expenses. As a response to the marriage penalty it was capricious—leaving substantial penalties in some cases and increasing

\textsuperscript{171} The income-stacking effect of joint returns may exacerbate the problems, however, by increasing the marginal tax rate at which these disincentive effects operate.

\textsuperscript{172} See supra text accompanying notes 98-100.


\textsuperscript{174} Id. at 34.

\textsuperscript{175} See Staff of the Joint Comm. on Taxation, 100th Cong., 1st Sess., supra note 100, at 19.
marriage bonuses in other cases. As a response to the extra expenses of a working wife, however, it was reasonably well crafted.

Congress was wrong to conflate the issues of joint returns and extra expenses of two-earner couples. They are two distinct issues that must be decided separately based on their own merits. The problem of imputed income and extra expenses is irrelevant to the question of whether spouses should be treated as one or two taxpayers; for purposes of this Article the extra-expense controversy needs no further consideration. As an aside, however, two points about the extra-expense controversy are worth noting.

a. Problems of broader significance: The nontaxation of imputed income, the nondeductibility of the cost of substitutes for imputed income, and the nondeductibility of mixed business-personal expenses are tax rules of general applicability, whose effects are not limited to wives. All persons who have to work for a living have reduced opportunity to generate imputed income and incur substantial work-related expenses for which they receive no tax allowance (commuting, clothing) or an inadequate allowance (child care). Traditionally, the moral drawn from this observation is that working wives are not treated any differently from other workers, and so relief targeted only at working wives is not justified. This viewpoint could accept, for example, a child care deduction or credit available to anyone who incurs employment-related child care costs, regardless of marital status; but it would not accept a deduction intended to reflect work-related expenses if it was available only to married secondary earners. McCaffery reaches a different conclusion, however, by considering behavioral effects rather than static notions of distributive neutrality. He notes that married women’s employment decisions are especially sensitive to tax disincentives and argues that the resulting relegation of wives to homemaker status has especially pernicious social effects. He concludes that the rules of general applicability

177. McCaffery makes this point: "[T]he deduction as a refinement of the income concept for two-earner families has nothing whatsoever to do with the marriage penalty." McCaffery, supra note 15, at 1010 n.102.
178. Bittker, supra note 12, at 1435.
180. Id. at 1046-53.
create special problems for wives, so he calls for special relief for wives.181

McCaffrey's point is well taken. Technically neutral rules may have far from neutral effects on behavior. I wonder, however, whether he would accept all the implications of his argument. For example, his argument suggests that it is important to provide general child care tax allowances for working wives, because their decisions to work are sensitive to such allowances and because encouraging them to work will help to erode outmoded gender role stereotypes. But a child care tax allowance for a working single parent, especially a father, would not be needed, because he will work regardless of tax rules and because his employed status brings us no nearer to any important social goal. I would not be willing to accept so great an elevation of incentive effects over fairness concerns, and I suspect that neither would McCaffery.

b. The offsetting human capital effect: If the tax laws are so discouraging to working wives, one might wonder why so many married women are employed. One reason commonly cited for the increased labor-force participation of wives, even in situations where employment offers little or no current net economic benefit, is the need for economic security in the case of divorce.182 Wives realize that their marriages may not last forever and that they cannot rely on their husbands' incomes (in the form of alimony payments) to support them adequately after divorce.183 A wife's best hope for financial security following a divorce is her own employment. Her chances for good post-divorce employment will be much better if she has built a solid employment record during marriage than if she must look for her first job as a divorced middle-aged homemaker.184

Thus an important motivation for many working wives is the enhancement of future earnings potential—the creation of human capital. Human capital is not, of course, taxed as it accrues. Instead, the realization requirement imposes tax only as the earnings potential generates earnings.185 This favorable tax treatment of human capital

181. See id. at 1009-10.
182. See, e.g., BERGMANN, supra note 107, at 51-54; Hanson & Ooms, supra note 107, at 633.
183. This is a major theme of WERTZMAN, supra note 70.
184. The evidence indicates that differing levels of human capital explain some, but by no means all, of the persistent gap between the average wages of men and women. BERGMANN, supra note 107, at 76-82.
counteracts, at least to some extent, the unfavorable treatment of costs of replacing imputed income and of mixed expenses.\textsuperscript{186} If the favorable effect is of roughly the same magnitude, then on balance the tax rules (other than the joint-return system) may not disfavor working wives after all.\textsuperscript{187}

It is difficult to quantify either the benefit of the human capital rules, or the detriment of the other rules, but it is possible to get an idea of the relative orders of magnitude. Suppose (fairly conservatively) that a wife's increase in earnings potential from spending this year in the labor force (rather than as a homemaker) is $1,000 per year for the next thirty years, and that the appropriate discount rate is 8\%. The present value of the resulting increase in human capital is $11,258. The favorable tax treatment of human capital allows the wife to exclude this amount from income.\textsuperscript{188} How does this compare with the countervailing tax detriment? A study conducted by Martin Murphy and Janice Peskin, based on data for 1976, estimated that an unemployed wife had $4,365 more imputed income from services than a wife with a full-time job.\textsuperscript{189} Adjusting for inflation, this is the equivalent of $10,450 in 1992 dollars.\textsuperscript{190} Nondeductible work-related expenses (other than replacements for imputed income) would make the detriment somewhat greater. It appears, however, that the beneficial and detrimental effects are of the same order of magnitude. Taking into account the favorable tax treatment of accretions to human capital, it is far from clear that the net effect of tax rules of general application (that is, rules not specifically related to marital status) really is oppressive to working wives.

\textsuperscript{186} This point is briefly alluded to by McIntyre \& Oldman, \textit{supra} note 13, at 1618.

\textsuperscript{187} The nontaxation of human capital accruals is not, of course, limited to working wives, but then neither is the tax treatment of imputed income and mixed expenses unique to working wives.

\textsuperscript{188} Actually, the net benefit is somewhat less than an exclusion of $11,258, because if that amount were taxed as it accrued, the taxpayer would be entitled to amortize it over 30 years (the appropriate method would be accelerated under a sinking fund analysis).


\textsuperscript{190} The inflation adjustment is based on data from \textit{Bureau of the Census, supra} note 59, Table 737.
C. The Effect of the Tax System on Marital Property Ownership

In addition to influencing decisions to marry and decisions to work, the tax treatment of married couples may also affect ownership of the spouses' earned income.

The joint-return system makes state law concerning the interspousal ownership of earned income irrelevant by permitting automatic splitting of income between spouses.\textsuperscript{191} At the other extreme, a strict separate-return system that always taxed earned income to the earner would also ignore state law concerning ownership of earned income within a marriage. This is the system I favor; it would be implemented by requiring all taxpayers to file as individuals \textit{and} by retaining \textit{Lucas v. Earl} (the general rule taxing earned income to the earner) and legislatively reversing \textit{Poe v. Seaborn} (thus extending the general rule of \textit{Earl} to community property jurisdictions).\textsuperscript{192}

There is a third possibility: a separate-return system that \textit{does} permit tax-effective assignments of earned income, either in all states (by overruling \textit{Earl}), or only in community property states (by retaining \textit{Seaborn}). Such a system would encourage husbands to share legal ownership of their earnings with their non-earning or lower-earning wives, in order to obtain the tax benefit of income splitting. This encouragement would function at the level of individual husbands if \textit{Earl} were repealed; it would function only at the state level (by encouraging states to adopt community property) if \textit{Seaborn} were retained and \textit{Earl} were not repealed.\textsuperscript{193} The significance of this

\textsuperscript{191} However, the splitting is at least favorable rates than those applicable to unmarried taxpayers. See supra text accompanying notes 4-10.

\textsuperscript{192} \textit{Earl} and \textit{Seaborn} are discussed supra text accompanying notes 20-22. The adoption of separate returns, in and of itself, does not preclude the possibility of splitting earned income. Income splitting is barred only if earned income must always be taxed to the earner. On the constitutionality of a legislative rejection of \textit{Seaborn}, see Gann, supra note 73, at 55-58 (concluding \textit{Seaborn} is not constitutionally required). Nothing in the \textit{Seaborn} opinion suggests it is constitutionally based, and it would be most strange if the relationship between income and the earner of the income were constitutionally insufficient to support a tax. \textit{Seaborn} has already been legislatively overruled by I.R.C. § 66 (West Supp. 1993) with respect to community property earned income of spouses living apart who do not file a joint return.

\textsuperscript{193} In Commissioner v. Harmon, 323 U.S. 44 (1944), the Supreme Court considered the tax consequences of an Oklahoma marital property regime that allowed spouses to elect into a community property system. The Court held that \textit{Earl}, rather than \textit{Seaborn}, was the governing precedent. If \textit{Harmon} were legislatively overruled, so that couples could split their earned income by opting into an optional community property system, the encouragement would operate at both levels: States would be encouraged to adopt optional community property systems, and couples would be encouraged to elect into such systems.
behavioral effect is not just speculation; it is demonstrated by the shift to community property after the Seaborn decision in 1930, and the shift away from community property after the 1948 legislation made community property irrelevant for tax purposes.\textsuperscript{194}

Pamela Gann is attracted by the behavioral effect of this third approach. She suggests that reform of marital property laws may be essential to protect the interests of non-earning and low-earning wives in the event of divorce.\textsuperscript{195} She notes that a system of separate returns that permits income shifting premised upon a wife's ownership of a husband's earnings would go far towards encouraging such reform.\textsuperscript{196} She applauds such a system for "interact[ing] positively with attempts to reform marital property laws."\textsuperscript{197}

However, Gann reluctantly rejects this approach because Congress would not extend similar income-splitting opportunities to unmarried persons, and without that extension the law would be unfair.\textsuperscript{198} I share her conclusion, but I reach it for different reasons.

I do not view encouraging the revision of state marital property regimes (or otherwise influencing the spousal ownership of property) as an appropriate use of the federal income tax. In light of federalism concerns and the strong tradition that marital property law is a matter for the states, it is debatable whether there is any legitimate federal

\begin{footnotes}
\textsuperscript{194} See supra text accompanying notes 23-28.
\textsuperscript{195} Gann, supra note 73, at 49. Equitable distribution offers substantial protection for wives, with respect to the distribution of property existing at the time of divorce. It does little, however, to ensure that the husband will not dissipate property before divorce. See infra text accompanying notes 223-24. Giving a non-earning wife current ownership of and control over a share of her husband's earnings would afford her more protection than equitable distribution.
\textsuperscript{196} Gann, supra note 73, at 50-52. Allocation of income from property under a separate-return system is discussed infra part IV.B. The choices mirror those discussed in this section regarding earned income. One possibility is to tax income from property to the legal owner of the property in all cases. Another is for legal title to control, except that interspousal gifts of property shall not be effective to shift tax liability. Finally, various mandatory allocation rules are possible, including allocating all property income to the higher-earning spouse, allocating property income in proportion to earned income, or dividing property income evenly between spouses. The rules other than a strict legal title regime differ greatly in how taxpayer friendly they are (the allocation of all property income to the higher-earning spouse is especially unfriendly), but they all share the feature of not allowing interspousal property transfers to affect tax liability. Thus they would all be unattractive to a proponent of using the tax system to improve the economic position of non-earning wives. A system which always respected legal title, however, would encourage the transfer of property to non-earning wives.
\textsuperscript{197} Gann, supra note 73, at 61. Susan Moller Okin has proposed a legal requirement that an employer pay wages half to the earner and half to the earner's spouse. Okin, supra note 142, at 180-81. If the proposal would produce a federal tax advantage, its prospects would be enhanced.
\textsuperscript{198} Gann, supra note 73, at 64.
\end{footnotes}
role in this area. But even assuming there is, it is not wise to pursue that role through the tax system. A feature as central to the individual income tax as the treatment of spouses should be designed to produce appropriate tax policy results, not to push the ownership of marital property in any particular direction. The objection is to tax legislation whose major purpose is to reform marital property law—not to legislation motivated by sound tax policy concerns that happens to have that effect.

Setting aside, then, its effect on the ownership of marital property, is a separate-return system that allows income splitting (by contract or by operation of state community property law) an attractive option? Such a system would have the same effect as a joint-return system with only marriage bonuses, except that spouses would have to share ownership of earnings to be eligible for the bonuses. Thus, the arguments in this Article against joint returns would also apply to this system, unless the ownership requirement affects those arguments.

The ownership requirement may give greater confidence that pooling is real—in other words, this system can be viewed as requiring proof of pooling, rather than automatically assuming it. But I have previously concluded that Earl was right and Seaborn was wrong: Under an income tax (as opposed to a consumption tax) income should be taxed to the person with the closest connection to its source, and that person is always the earner, regardless of contractual assignments or marital property regimes. Under this analysis, income splitting is not appropriate regardless of legal ownership of earned income. Ownership also makes no difference to the analysis of the effect of joint returns on a wife’s decision to work. Assuming a couple takes advantage of the opportunity to split the husband’s income, the wife’s income will still be stacked on top of the husband’s, and she will be discouraged from working. In short, I reject this de facto joint-

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199. Gann also objects to joint returns because they give tax benefits based on the assumption of shared income, without requiring the reality. Id. at 61. This is a different argument from that criticized in the text. One can reject (as I do) the notion that the federal tax laws should be designed to influence the ownership of marital property, and still accept the notion that the tax laws should not reward spouses for sharing that does not exist.

200. The system in effect in the United States from 1948 to 1969 is an example. See supra note 4 and accompanying text.

201. Of course, even if one favored joint returns, one might not favor this system’s production of marriage bonuses only.

202. See supra text accompanying notes 72-85.
return system for the same reasons I rejected a de jure joint-return system.

IV. DESIGNING A SEPARATE-RETURN SYSTEM

If spouses are required to file separate returns there must be rules for determining how income (especially property income), deductions, and credits are allocated between the spouses. For the most part, advocates of separate returns have given scant consideration to these design issues. These issues deserve more consideration than they have received, for two reasons. First, however strong the theoretical case for a separate-return system, the system will be accepted only if fair and workable solutions to the allocation problems can be developed. Second, thinking through the allocation problems affords a good test of the theoretical arguments for separate returns. The allocation problems are not merely practical; they are difficult precisely because there is a great deal of marital pooling. Problems of abuse of and disrespect for the tax system arise when behavior of little or no non-tax significance is accorded tax significance. If couples that pool resources consider who owns property or who incurs expenses of no non-tax significance, but the tax system treats those factors as determinative, there will be problems: There will be opportunities for some to manipulate the system and pitfalls for others.

These allocation problems are, in fact, the strongest argument in favor of retaining the joint-return system. My view is that this is a significant advantage of joint returns, but that there are satisfactory solutions to the allocation problems, and that this one advantage of joint returns is not enough to overcome the superiority of separate returns in other respects. In addition, a separate-return system avoids one practical problem inherent in joint returns: the need to determine marital status for federal income tax purposes. This determination

203. The most comprehensive discussion of options is in Staff of the Joint Comm. on Taxation, 96th Cong., 2d Sess., supra note 12, at 38-46, although the Staff does not make recommendations among the options. Articles advocating separate returns, but containing rather cursory discussions of allocation of property income and of deductions, include: Gann, supra note 73, at 65 n.208 (mentioning the deduction allocation question); Philip J. Harmelink, Marital Status Tax Discrimination After Tax Reform: Proposals to Resolve the Penalty/Bonus Issues, 26 Willamette L. Rev. 593, 632 (1990) (declaring that allocation problems are "relatively easy to deal with"); Kornhauser, supra note 36, at 108 n.146; Note, supra note 79, at 378-81; Laura Ann Davis, Note, A Feminist Justification for the Adoption of an Individual Filing System, 62 S. Cal. L. Rev. 197, 242-48 (1988) (considering the allocation of property income in some detail, but merely noting the allocation of deductions in passing).
can be surprisingly difficult in some situations.204 Toni Robinson and Mary Moers Wenig call for the abandonment of marital status as a tax determinant because of the severity of these problems.205 They do not, however, compare the marital status problem peculiar to joint returns with the spousal allocation problem peculiar to separate returns. Even if the problems are of equal theoretical complexity, spousal allocation will inevitably be a bigger problem in practice. Only a small number of persons are of doubtful marital status; for most persons determining marital status is no problem at all. By contrast, under separate returns every couple with property income or itemized deductions will be faced with allocation problems—possibly many problems for each couple.

A. ALLOCATION OF EARNED INCOME

Taxing earned income to the earner is at the core of the justification for separate returns—both in terms of imposing the tax on the person in control of the income source and in terms of removing the second-earner disincentive of current law. Thus a separate-return system should retain Earl and reject Seaborn.206

In the vast majority of cases there is no question as to which spouse earned a particular item of income, so taxation to the earner will involve neither complexity nor opportunity for abuse. In family businesses, however, there will be some incentive for artificial allocations of earned income to spouses (typically wives). This was also an issue under pre-1948 law, which was addressed by family partnership litigation.207 It remains an issue today because of the potential for

204. The difficulties are described in exhaustive detail in Toni Robinson & Mary Moers Wenig, Marry in Hast, Repent at Tax Time: Marital Status as a Tax Determinant, 8 VA. TAX REV. 773 (1989).

205. Id. at 850.


207. For a history of pre-1948 litigation involving family partnerships, see Jones, supra note 24, at 274-91. The leading family partnership case was decided after the adoption of joint returns, and involved a partnership with the taxpayer’s children, rather than the taxpayer’s
splitting income with family members other than spouses. It does not appear to be a major problem, however. Stanley Surrey opined in 1948 that the courts were "doing a respectable job in separating the wheat from the chaff in this field," and the area has not been heavily litigated in recent years.

In addition to partnerships, artificial shifting of earned income from a high income spouse to a low income spouse might be accomplished by a sole proprietor paying an unreasonably large salary to a spouse or by a corporation owned and managed by one spouse disguising part of that spouse’s salary as salary of the other spouse. A blanket disallowance of any deduction for amounts paid to spouses in these situations is a possible response. That seems draconian, however, considering that such payments are often legitimate. In the 1990s, a rule fairly characterized as a conclusive presumption of the worthlessness of a wife’s services is unacceptable.

The two-earner deduction of section 221, in effect from 1981 to 1986, had the same effect as separate returns, in that it created an incentive for artificial diversions of earned income to wives. Yet there

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208. In 1951 Congress entered this area by enacting the predecessor of current I.R.C. § 704(e), concerning family partnerships. Revenue Act of 1951, Pub. L. No. 183, § 340, 65 Stat. 452. The focus of the provision, however, is on the taxation of income generated by capital, rather than by services.


210. The paucity of litigation is due in part to the relative flatness of the tax rates since 1986, which has reduced the potential tax savings from shifting income to children and other relatives.

211. This applies only to wages paid by a husband in connection with his business. Wages paid for personal services would not accomplish income shifting, because the wages would not be deductible by the husband.

212. The former two-earner deduction did not apply to amounts received in the employ of one’s spouse. I.R.C. § 221(b)(2)(A)(v) (repealed 1986). The Staff of the Joint Committee gave two reasons for the exclusion: “[T]he existing exemption of these wages from social security tax already provides substantial relief to these second earners, and [the exclusion eliminates] opportunities to shift earned income between spouses and attribute an inaccurate or unreasonable amount of earned income to the second earner.” STAFF OF THE JOINT COMMITTEE ON TAXATION, 97TH CONG., 1ST SESS. 33, supra note 173, at 36-37 n.3. The second reason appears contrived, however, as the explanation continues: “If the employer is a corporation owned by the spouse rather than an unincorporated spouse, wages paid to the employee are not exempt from social security taxes and are therefore included in qualified earned income.” Id.

213. Canada reached the same conclusion, under its separate return system, in 1980. Prior to that year, the law disregarded any compensation paid by one spouse to another. Income Tax Act § 4(3) (repealed by 1980-81-82-83, c. 48, S. 40(1)). The change in the law resulted from pressure from women’s groups. Dulude, supra note 35, at 83.

214. See supra text accompanying notes 98-99.
were no reported cases under section 221 of controversies on this issue. Reported cases, of course, may be only the tip of an iceberg; but if there is no tip, there is probably not much of an iceberg.\textsuperscript{215}

B. Allocation of Income from Property

The allocation of property income is less important than the allocation of earned income, both because there is much less of it\textsuperscript{216} and because the most important behavioral effect is on earned income. It is a more difficult problem, however, because there is more opportunity to manipulate a rule that taxes property income to the owner than there is to abuse a rule that taxes earned income to the earner.

There are five important options for the treatment of property income. (1) Tax the income to the owner of the property. This is the general income tax rule.\textsuperscript{217} (2) Tax the income according to ownership, except do not give tax effect to interspousal transfers of property. Under this approach, if a husband gave property to his wife, he would continue to be taxed on the income from the property (or any replacement property).\textsuperscript{218} (3) Allocate all property income to the higher-earning spouse.\textsuperscript{219} (4) Allocate property income between the spouses in proportion to their earned incomes. (5) Allocate property income equally between the spouses.

\textsuperscript{215} The absence of cases may be partly explicable by I.R.C. § 221(b)(2)(A)(v), which denied the deduction for amounts received in the employ of one's spouse. If a separate-return system did not follow that approach, it might generate more litigation than did the two-earner deduction. However, the two-earner deduction still had litigation potential with respect to partnerships and corporations, yet no litigation materialized.

The absence of litigation may also be partly explained by the limited potential tax savings from shifting income to a spouse to take advantage of the two-earner deduction. At most the shift could have generated only a $1,500 income tax reduction for a couple (based on the maximum $3,000 deduction and the then-maximum tax rate of 50%). Moreover, in some cases the income tax benefit would have been more than offset by a social security tax detriment. This detriment would have resulted if compensation was shifted from a spouse who would not have been subject to social security tax on the compensation (because he had already paid the maximum social security tax) to a spouse who would be subject to social security tax.

\textsuperscript{216} Income from property constitutes only about 10% of all adjusted gross income. See Alicia H. Munnell, The Couple versus the Individual under the Federal Personal Income Tax, in The Economics of Taxation 247, 274 (Henry J. Aaron & Michael J. Boskin eds., 1980).

\textsuperscript{217} Helvering v. Horst, 311 U.S. 112 (1940). If actual ownership under state law differs from legal title, ownership governs for tax purposes. Staff of the Joint Comm. on Taxation, 96th Cong., 2d Sess., supra note 12, at 99.

\textsuperscript{218} This is the rule under the Canadian separate-return system. Income Tax Act § 74(1)(1) (1985).

\textsuperscript{219} This is similar to the British system, described in Dulude, supra note 35, at 76-79, of permitting a second earner to file a separate return only with respect to her earned income.
1. Respecting Ownership: Marriage Neutrality

Of the five options listed above, only the first is truly marriage neutral; all the other options take marriage into account in determining tax liabilities. The first option will encourage gifts of income-producing property to non-earning and low-earning wives, which is a behavioral effect some find attractive. Although I do not share the desire to use the tax laws for the purpose of influencing ownership of marital assets, I have no objection to that result as a side effect of a system justifiable on the ground that it achieves true marriage neutrality.

The crucial question is whether division of ownership of assets between spouses has enough economic significance to be determinative for tax purposes. The development of the law of equitable distribution in most common law property states decreases the significance of ownership. Assume the husband is the owner of all the property in the marriage, but the wife has a right under state law to half of that property in the event of divorce. Should this be enough to make the wife taxable on half the property income, even if the husband retains technical ownership? No, because the key to taxation is control over the income-producing property, and the husband has that control during the marriage. However, a rule is developing in some equitable distribution states that a spouse must account upon divorce for property which would have been available for equitable distribution had the spouse not dissipated it during marriage. For example, if the husband had dissipated half of the property that should have been available for equitable distribution, he might be "awarded" the dissipated property as his share, so that the wife received all the remaining property. It is far from clear, however, what constitutes dissipation, beyond the easy case of gifts to a lover. Conceivably

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220. Davis, supra note 203, at 242-47. The tax incentive will not be merely to give half of the income-producing marital property to the wife; rather the incentive will be to give all property to the wife, until the point at which the spouses' marginal tax rates are equal. The transfer tax system already encourages gifts to spouses (typically wives) to ensure that the estate of whichever spouse dies first will have enough assets to take full advantage of the unified credit. See I.R.C. § 2010 (West Supp. 1993).

221. See supra text accompanying note 193 (discussing the possibility of using separate returns and the repeal of Earl to encourage giving spouses ownership interests in one another's earnings).

222. See sources cited supra note 67.


224. Id. at 111-16.
dissipation doctrine could some day develop to the point where both spouses would truly share control over property subject to equitable distribution, so that they should be taxed as co-owners, but that day has not arrived.

In the case of jointly owned property, the ownership rule would tax income to the owners in proportion to their ownership interests. Laura Ann Davis argues, however, that this rule is too generous with respect to community property because community property laws frequently allow one spouse to sell or encumber community property without the consent of the other.\footnote{Davis, supra note 203, at 239 (citing Cal. Civ. Code § 5125 (West 1988)).} She argues that this gives the person whose labor created the community property effective control over the property and that the tax liability on the income from the property should be allocated accordingly—between the spouses in proportion to their contributions to the community property.\footnote{Id. at 243-46.} In addition to being very difficult to administer, the Davis approach is not justified in theory. As long as community property law gives equal management power to both spouses, they should be taxed as co-owners of the property. Davis may be right that the dynamics of a particular marriage may result in a husband trampling a wife’s community property rights, but that is true even of a wife’s separate property (for example, a husband demanding that his wife “sign this”). On the other hand, there are some community property states, including Texas, in which each spouse has exclusive management power over his or her own earnings, despite the fact that the earnings are community property.\footnote{systems of this sort are discussed by Kornhauser, supra note 36, at 74 n.35. An example is Tex. Fam. Code Ann. § 5.22 (West 1993).} As to these states, Davis’ point would be well taken. Income from community property subject to the exclusive control of one spouse should be taxed entirely to that spouse.

Different husbands will react differently to the incentive to make gifts to their wives, under a tax system that respects ownership of income-producing assets. Those especially secure in their marriages and those especially eager for tax savings will take full advantage; others will not. This does create a sort of happy-marriage tax bonus, but only in the same way that the ability to shift taxes by gifts of income-producing property has always created a happy-family tax bonus.
2. **Policing Interspousal Transfers**

The second option—the Canadian approach of respecting ownership *except* in the case of inter-spousal transfers—strikes me as unattractive. First, it does not make much theoretical sense. If the spousal division of asset ownership is generally significant enough to govern tax consequences, why is it not significant enough in the case of interspousal gifts? The answer must be a distaste for tax-motivated transactions. But if the transactions have substantial economic effect they should be respected despite their motivation; and the general respect for ownership under such a system assumes ownership *does* have substantial economic effect.

Apart from the weak theoretical justification, this rule is difficult to enforce; clever taxpayers can often evade it. The Canadian rule has had major problems of this sort. Some have been solved through legislative amendments, but others remain. One unavoidable problem is the necessity of tracing when a wife disposes of investment assets received from her husband, but acquires other assets. Another is the manipulation of consumption expenditures. If a wife has any significant income of her own (either earned or unearned), the couple can arrange for all their current consumption to be financed by the husband’s earnings. This allows all of the wife’s income to be saved, thus giving the wife substantial property income really financed by a gift (of consumption) from the husband, but not subject to the rule.

I am more sympathetic, however, to a rule based on a much narrower sort of suspicion of interspousal gifts: Such a rule would not allow income shifting through the use of gifts *in trust* to a spouse. It is reasonable to limit the privilege of income shifting to an outright gift transferring full control to the spouse, rather than extending it to gifts in trust. Incidentally, this result would obtain under the current grantor trust rules, which treat the grantor as holding any power or interest of the grantor’s spouse.

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228. For example, Income Tax Act § 74.1(1) now applies to loans to a spouse, but it did not do so before 1985. Dulude, supra note 35, at 83.

229. For example, the anti-shifting provision applies to income from “property,” but not to income from a business. Income Tax Act § 74.1(1) (1985); Dulude, supra note 35, at 83.

230. This would mean income shifting could not be accomplished by an inter vivos QTIP (qualified terminable interest property) trust described in I.R.C. § 2523(f) (West Supp. 1993).

231. I.R.C. § 672(e) (West Supp. 1993). In addition, I.R.C. § 677(a) (West Supp. 1993) treats the grantor as the owner of the trust if the income may benefit the grantor or the grantor’s spouse.
3. Behavioral Effects on Earned Income

If one's primary concern is eliminating the disincentive to married women entering the labor force, created by the stacking effect of joint returns, the most attractive approach to property income is the third approach—allocating all property income to the higher-earning spouse. (It is somewhat ironic that this approach is the least favorable in terms of the combined tax liabilities of the spouses.) This approach ensures that the first dollars earned by the wife will be taxed at the bottom of the rate schedule. By contrast, the first approach (based on ownership) encourages gifts of income-producing property to wives; thus, a wife's lower brackets may have been used up by her property income. The Canadian approach is better in this respect because it does not encourage gifts, but the wife's lower brackets may still have been used up by income from her own property. The fifty-fifty allocation also has major potential for occupying a wife's lower brackets with unearned income. The allocation in proportion to earned income does guarantee that some space in the lower brackets will be available for the wife's earned income, but it has the effect of narrowing the widths of those brackets (because part of each bracket is absorbed by property income).

4. Constitutional Objections to Rules Not Based on Actual Ownership

All of the allocation rules except the first ignore actual ownership—the second under certain conditions, and the others under all conditions. Are these rules subject to serious constitutional objection on the grounds that they may result in taxing a person on income with which the person has no connection?\(^{232}\) The constitutional objection to the second allocation rule does not seem very serious. It would be difficult for a husband to argue he lacks a significant connection with property he once owned and then gave to his wife, who continues to own it or now owns replacement property. The other rules, however, create the possibility of taxing one spouse on the income from property with which the spouse has no connection at all, except that it is owned by the other spouse.

\(^{232}\) The joint-return system makes one spouse liable for tax on the other spouse's income, but any constitutional objection is vitiated by the fact that a spouse can always avoid that result by electing to file a separate return.
It is not necessary that allocation of income for the purpose of imposing tax liability follow allocation of income for the purpose of rate determination. This distinction already exists in the "kiddie tax," which aggregates the unearned income of a child under the age of fourteen with the income of his parents for the purpose of rate determination, but which imposes the liability for tax on the child. Similarly, a separate-return system could aggregate all unearned income with the income of the higher-earning spouse to determine the tax rate on the unearned income, but impose the liability for the tax on the actual owner of the income. This would avoid taxing anyone on income from property the person did not own. But would it also avoid the constitutional objection?

Even if the system follows the kiddie tax model, there would still be an objection, based on the 1931 Supreme Court opinion in Hooper v. Tax Commission of Wisconsin. The Wisconsin income tax required the aggregation of the incomes of spouses for the purpose of determining tax rates. With respect to liability for tax, the statute provided a choice: The husband could be liable for the entire tax, or liability could be apportioned between the spouses according to their relative incomes. The effect of the second option was to tax the husband only on his own income, but at rates determined by considering the wife's income. The Court ruled the tax violated the Fourteenth Amendment. It explained: "[A]ny attempt by a state to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law . . . ."

Both on its facts and in its language, Hooper appears to prohibit not only taxing one person's income to another, but also using one person's income to determine the rate of tax on another. If that is so, then the kiddie tax model would be unconstitutional. Two district courts, however, have rejected Hooper-based constitutional challenges to the kiddie tax. Both opinions distinguish Hooper on the grounds that Hooper involved taxing one person on the income of another,
rather than merely using another's income for rate determination.\footnote{238}{\textit{Butler}, 798 F. Supp. at 576; \textit{Carlton}, 789 F. Supp. at 748.} Given the second option under the Wisconsin tax, that distinction is simply wrong. The result reached by the two cases is, nevertheless, almost certainly correct. \textit{Hooper} is a remnant from an era in which the Supreme Court applied much stricter constitutional scrutiny to tax and other economic legislation than it does today. Today, such legislation will be upheld against equal protection or substantive due process challenges as long as it has a rational basis—which the kiddie tax surely does.\footnote{239}{For a description of the Supreme Court's current approach to rational basis analysis of tax laws, see Lawrence Zelenak, \textit{Are Rifle Shot Transition Rules and Other Ad Hoc Tax Legislation Constitutional?}, 44 Tax L. Rev. 563, 569-88 (1989).} Although \textit{Hooper} has never been formally overruled, it is quite clearly not good law today. Pamela Gann has also reached this conclusion.\footnote{240}{\textit{Gann}, supra note 73, at 55-58.} She relies especially on \textit{Fernandez v. Wiener},\footnote{241}{326 U.S. 340 (1945).} a 1945 opinion upholding a federal estate tax provision including in a husband's estate the wife's share of community property (except to the extent the community property came from the wife's earnings). The Court rejected the constitutionality argument without even mentioning \textit{Hooper}.\footnote{242}{Id. at 357.}

Although \textit{Hooper} creates a slight doubt, it is reasonably clear that the kiddie tax is constitutional. By the same analysis, a rule that had the effect of allocating one spouse's income to the other spouse for rate determination would also be constitutional.

5. \textit{Selecting a Rule}

On balance, I find the first option most attractive. It is the only option that achieves true marriage neutrality and thus is fully consistent with the underlying premise of separate returns. The control that goes with ownership has sufficient economic reality to justify respecting ownership for tax purposes, even as between spouses. Although I would not adopt a rule for the purpose of encouraging gifts to non-earning wives, I am happy to accept that encouragement as a side effect. On the other hand, the first option does have a few drawbacks. It places a heavy premium on careful tax planning, it is more complicated to administer than an automatic allocation rule, and it reintroduces a significant work disincentive when the husband has made major gifts to the wife.
I think these drawbacks are tolerable, but someone more troubled by these drawbacks would select the third option (all property income taxed to the higher-earning spouse). It eliminates tax planning concerning property ownership, it is simple to administer, and it creates no work disincentive for the wife. 243 Although the third option violates the principle of marriage neutrality, the majority of couples do not have significant taxable income from property and for those couples the option does achieve marriage neutrality. 244 The choice between the first and third options comes down, of course, to the relative importance one attaches to the areas in which each is stronger. I give more importance to the first option’s strengths, but that conclusion is certainly debatable.

C. ALLOCATIONS OF DEDUCTIONS AND CREDITS

The obvious rule for deductions and credits associated with the production of income (either earned or from property) is to allocate those items to the spouse reporting the related income. It is not obvious, however, how personal deductions and credits (not associated with taxable income) should be allocated between spouses. The possible rules for allocating deductions and credits between spouses are similar to the choices for allocating property income. The important options are: (1) Allocate items to the spouse who incurred the deductible or creditable expense. 245 Thus, for example, medical expenses would be deductible by the treated spouse, state and local taxes would be deductible by the spouse (or spouses) liable for the taxes, and home mortgage interest would be deductible by the debtor spouse (or spouses). Charitable contributions, which do not ordinarily involve the incurring of a liability, would be deductible by the spouse making

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243. The fourth option (allocation of property income in proportion to earned income) shares the first two of these features, and is reasonably good on the work disincentive problem.

244. This option can impose rather severe marriage penalties when a non-earning woman with substantial property income marries a high-earning man. The marriage then results in the property income being stacked on top of the husband’s earned income, so that the benefit of the wife’s lower brackets is lost. This is neither a particularly common nor a particularly heart-rending situation, however.

245. This was the rule under the pre-1948 separate return system. Bittker, supra note 12, at 1441 n.144. The current rule, for spouses who choose to file separate returns, is that an expense is deductible only by a spouse who both incurs and pays the expense. STAFF OF THE JOINT COMM. ON TAXATION, 96TH CONG., 2D SESS., supra note 12, at 40-44. If, for example, one spouse pays the property tax liability of the other, neither may deduct the tax on a separate return. Id. at 42. However, medical expenses are deductible by the paying spouse, regardless of who incurred the expenses. Id. at 41.
the payment. (2) Allocate all items to the spouse making the payment, regardless of who incurred the liability. (3) Allocate items according to some formula, without regard to either liability or payment. Possible formulas include allocating items 100% to the higher income spouse, allocating items evenly between spouses, or allocating items in proportion to income.

Only the first option is truly marriage neutral. Allocation formulas are obviously not marriage neutral, but allocation according to payment also violates marriage neutrality. If a taxpayer paid the expenses of a relative other than a spouse, the relative would be entitled to the deduction. The transaction would be analyzed as a gift to the relative, followed by payment of the expense by the relative.246

There is a serious practical problem, however, with the first option: the possibility that deductions will be lost because the spouse incurring the expense does not have enough income to use the deduction. This could be addressed by allowing transfer of the deduction to the other spouse in such cases, but that solution has two problems of its own. First, it violates the principle of marriage neutrality (because transfers of deductions to non-spouses are not permitted), which was the major attraction of the first option. Second, if transfer is permitted from a spouse in the zero tax bracket, it is hard to see why transfer should not also be permitted from a spouse in any low bracket to a spouse in a higher bracket. But allowing general transferability would completely abandon marriage neutrality for deductions.

Congress may decide that the occasional lost deduction is a price worth paying for marriage neutrality and adopt the first option in its pure form. But consider the likely behavioral effect of that rule, as applied to the home mortgage interest deduction and the property tax deduction. In order to ensure that the deductions were not wasted, one-earner couples would hold their homes (and other assets subject to property tax) solely in the name of the earner spouse.247 Just as marriage neutral treatment of income-producing property works to the benefit of traditional wives, marriage neutral treatment of deduction-producing property works to the detriment of traditional wives. For the many couples whose most important asset is their home, the

246. See, e.g., Tuer v. Commissioner, 46 TAx Ct. Mem. Dec. (CCH) 870 (1983) (holding the taxpayer was not entitled to a deduction for paying the property tax liability of a relative).

247. Perhaps a non-earner spouse could be jointly liable on a mortgage without being a co-owner of the home, but the economic reality of that liability would be dubious if the spouse has neither income nor property with which to pay off the debt. In any event, joint liability on the mortgage would not solve the property tax problem.
detrimental effect on the deduction side is more significant than the beneficial effect on the income side. Although I do not think it is the duty of the federal income tax to encourage transfers of property to non-earning spouses, a rule that actively discourages home (and other asset) ownership by married women is unacceptable.248

What, then, of the other options? The second option (allocation of deductions based on payment) would put a tremendous premium on tax planning, and would be almost impossible to enforce. A formula allocation rule is clearly preferable. Among the possible formulas, I would reject a fifty-fifty rule, because it has one of the same problems as the first option: It creates the possibility that one spouse will not have enough income to use the allocated deductions.249 This problem could be avoided by allocating deductions between spouses in proportion to their incomes. It could also be avoided by the most taxpayer-favorable of all possible rules: Allocate deductions entirely to the higher income spouse until the deductions have equalized taxable incomes, and after that allocate deductions evenly between the spouses.

Either allocation in proportion to income or taxpayer-favorable allocation is a reasonable choice for deductions not associated with the production of income.250 I would combine one of these rules with allocation of income-related expenses to the spouse taxable on the income.

I am somewhat troubled by the apparent inconsistency between an ownership-based allocation rule for property income and a formula allocation rule for personal deductions. I think the distinction is justified, however, for three reasons. First, it is one thing to tell owners of substantial income-producing property that they must do careful tax planning or suffer the consequences; it is quite another thing to impose the same burden on every couple with personal deductions. Second, the consequences of bad planning for deductions under a

248. It would be possible to have some sort of formula allocation rule for those itemized deductions as to which a marriage neutral system would have unfortunate behavioral effects, and a marriage neutral system for other itemized deductions. But that level of complexity should be avoided for rules affecting millions of taxpayers.

249. This problem is noted by Winn & Winn, supra note 206, at 874. As discussed above, the problem could be addressed by reallocating deductions to the extent necessary to prevent waste, but in that case why not also allow reallocation whenever it would result in the use of deductions against higher-bracket income? At that point it is no longer a fifty-fifty allocation rule at all. Rather, it is the taxpayer-favorable rule described in the text.

250. The choice between the two rules affects the treatment of the spouses' standard deductions, as discussed infra part IV.D.2.
marriage neutral system are more severe than the tax consequences of bad planning for property income. Bad planning for deductions may cause loss of all tax benefits; bad planning for property income will affect only the rate of tax. Finally, the behavioral effect of a marriage neutral rule for property income is attractive, while the behavioral effect of a marriage neutral rule for deductions is perverse.

D. Other Issues Concerning Marital Status and Separate Returns

Apart from problems of allocating income and expenditures between spouses, there are a number of other areas where marital status might or might not be treated as relevant under a separate-return system. This section considers several of the more important of those areas. It is not intended to be exhaustive, although it should provide some guidance in thinking about similar issues not discussed.

1. May One Spouse Itemize and the Other Claim the Standard Deduction?

When spouses file separate returns under current law, one spouse may not claim the standard deduction if the other spouse itemizes. Should this rule be retained under a mandatory separate-return system? The rule must be understood in context: It is part of a system in which who incurs an expense and who pays an expense determine who may deduct the expense. In such a system there is opportunity to manipulate itemized deductions so that most or all of a couple’s deductions are allocated to one spouse. The standard deduction can be viewed as a sort of conclusive presumption that a taxpayer who claims the standard deduction has itemized deductions equal to the standard deduction; the standard deduction saves the taxpayer the trouble of having to prove it. Although this is a very generous presumption, it is not entirely without basis in fact; most taxpayers claiming the standard deduction have some itemized deductions. But when spouses file separate returns, it is reasonable to suspect that all itemized deductions have been allocated to one spouse, so that the other spouse should not get the benefit of the conclusive presumption reflected in the standard deduction.

252. See Note, supra note 79, at 382 n.74, which concludes (with almost no elaboration) that the rule should be retained.
253. See supra note 245.
The current rule can also be understood as an effort not to give spouses an incentive to file separate returns. Suppose, for example, the standard deduction for a joint return is $6,000, the standard deduction for spouses filing separately is $3,000, and a couple has $6,000 of itemized deductions, all of which can be allocated to the husband on a separate return. If they file a joint return, they will have only a $6,000 standard deduction. But if they file separate returns, the husband takes $6,000 of itemized deductions, and the wife can still take a $3,000 standard deduction, their combined taxable income will be $3,000 less with separate returns. Not allowing the wife the standard deduction removes this incentive for separate returns.

I have proposed mandatory separate returns, with itemized deductions allocated either in proportion to spousal income, or in the most taxpayer-favorable way possible. Under the proportionate allocation method, it is clear that one spouse should not be denied the standard deduction because the other spouse itemizes. There is no opportunity for manipulation, and no reason to suspect that the non-itemizing spouse lacks any itemized deductions. There is also, of course, no desire to discourage separate returns.

The analysis is different if all itemized deductions are allocated to the higher income spouse (until taxable incomes have been equalized). Since the allocation rule is automatic there is still no chance for manipulation, and there is still no desire to discourage separate returns. However, it is not merely likely, but certain, that the non-itemizing spouse has no itemized deductions. In that situation, it would be fair to deny the standard deduction to the non-itemizing spouse. Thus I would (1) deny the standard deduction to the non-itemizing spouse under a taxpayer-favorable allocation rule but (2) permit the deduction under a proportionate allocation rule.

254. This is true unless the taxable incomes have been equalized, so that deductions have been allocated to both spouses.

255. Note that this will create some situations where one spouse could itemize, but it would reduce the spouses' combined taxable incomes if that spouse chose not to. This would be the case whenever the allocation of all itemized deductions to the higher income spouse resulted in itemized deductions greater than one and less than two standard deductions. Whether not itemizing in this situation would reduce the spouses' combined tax liabilities would depend on their marginal tax rates.

256. There could be an exception in cases where the rule has the effect of allocating some deductions to the lower income spouse, but this would create a "cliff effect," where the allocation of one dollar of deduction to the lower income spouse would result in several thousand dollars of standard deduction.

257. Will taxpayers fare better under (1) taxpayer-favorable allocation and standard-deduction denial, or under (2) proportionate allocation and standard-deduction allowance? It depends
Either of these rules is less attractive than absolute marriage neutrality in terms of not discouraging wives from working. Under absolute marriage neutrality, the first dollars earned by a wife are always taxed at the rate of zero because of the standard deduction. Under rule (1), however, the wife may not be entitled to a standard deduction. If she is not, even her first dollars of income will be taxed.\textsuperscript{258} This is not ideal, but it is not nearly as bad as joint returns. Her first dollars of income will be taxed at the lowest positive tax rate rather than at her husband’s marginal rate. And in many cases, of course, rule (1) will not deny the standard deduction to the wife. Under rule (2), a slight work disincentive is created by shifting itemized deductions from husband to wife. Suppose the husband has $38,000 income (taxed at a 28% marginal rate), the couple has $5,000 of itemized deductions, and the standard deduction is $3,000. If the wife earns $2,000 by working part time, the $2,000 is not taxed to her because of her standard deduction. However, her earnings decrease her husband’s share of the itemized deductions by $250 (5% of $5,000), increasing his tax liability by $70 (28% of $250). Considering both spouses together, the wife’s $2,000 has been taxed at an effective rate of 3.5% ($70/$2,000). The work disincentive created by a rate that low should be tolerable.\textsuperscript{259}

2. The Personal Exemption Problem

Under current law, if spouses do not file a joint return and only one spouse has income, the spouse with income may claim a personal

\textsuperscript{258} Her personal exemption will not solve this problem, because (as discussed infra part IV.D.2) personal exemptions should be allocated consistently with itemized deductions. Thus, her personal exemption will shelter not her income, but the income of her higher-earning husband.

\textsuperscript{259} Applying the same allocation rule to personal and dependency exemptions increases the effective rate (as discussed infra text accompanying note 269), but it will ordinarily remain quite low.
exemption for the other spouse. As long as personal exemptions are generally available for persons supported by a taxpayer, this rule should be retained for mandatory separate returns. Where both spouses have income, however, one would expect the law to require each spouse to claim his or her own personal exemption. If these are the rules, then a wife's decision to work shifts her personal exemption from her husband to herself. The problem is that the shift has the effect of taxing the wife's first dollars of income (up to the personal exemption amount) at the husband's marginal tax rate. Suppose the personal exemption is $2,000, the husband is in the 28% bracket, and the wife earns $2,000. The wife's earnings are not taxed to the wife, but they cause the husband to lose the wife's personal exemption, thus increasing his taxable income by $2,000 and his tax liability by $560. This results in a work disincentive, especially for part-time work, of the kind that separate returns were supposed to eliminate.

One solution would be to convert the personal allowance from a deduction equivalent to a credit so that the tax benefit would be the same no matter who claimed the credit. If the personal allowance remains in deduction form, any answer to this problem will violate the principle of strict marriage neutrality. That is a price worth paying, however, to avoid the work disincentive effect. The solution is to apply the same allocation rule that is adopted for itemized deductions to the spouses' personal exemptions. Depending on how itemized deductions are allocated, either allocate both exemptions entirely to the higher income spouse or allocate the exemptions between the spouses in proportion to their incomes. The former approach entirely avoids the work disincentive problem. The latter approach involves a

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261. Under current law, a taxpayer may not claim an exemption for a dependent if the dependent has income greater than the personal exemption amount, except in the case of a child of the taxpayer who is either under nineteen or a student under twenty-four. I.R.C. § 151(c)(1) (West Supp. 1993).
262. For the benefit of the credit to be completely independent of the identity of the taxpayer, it would have to be refundable.
263. It may seem that allowing a husband a personal exemption for a non-earning wife already violates marriage neutrality. It really does not, however, because a taxpayer may claim a personal exemption for any member of his household whom he supports, unless their relationship violates local law. I.R.C. § 152(a)(9), (b)(5) (West Supp. 1993).
264. See supra part IV.D.
265. This proposal would resemble the treatment of dependency exemptions for children under current law. A parent may claim an exemption for a child under nineteen (or under twenty-four, if a student) regardless of the child's income, as long as the parent supplies over half of the child's support. I.R.C. §§ 151(c)(1), 152(a) (West Supp. 1993). In the interests of simplicity, the proposal would dispense with the support requirement as between spouses.
small work disincentive, because the wife's work causes some shifting of the exemptions from the husband's higher bracket to her lower bracket, but the effect is modest enough to be tolerable.\textsuperscript{266} The chosen allocation rule should also be used to assign dependency exemptions (for children and other dependents) between the spouses.

3. \textit{The Earned Income Credit}

The earned income credit\textsuperscript{267} was intended by Congress to help the working poor and to encourage persons on welfare to find work.\textsuperscript{268} The size of the credit depends, in part, on whether one has one, two or more, or no "qualifying children."\textsuperscript{269} When fully phased in (in 1996), the credit (which is refundable) for taxpayers with two or more qualifying children will be 40% of the first $8,425 of earned income.\textsuperscript{270} It is phased out at the rate of 21.06%\textsuperscript{271} as adjusted gross income exceeds $11,000.\textsuperscript{272} The phaseout rate and range are the same for married couples filing joint returns as for singles. This creates a severe marriage penalty.\textsuperscript{273}

\begin{itemize}
\item \textbf{a. If the current credit design is retained:} The earned income credit presents a difficult problem in designing a separate-return system. If a wife of a high income husband earns a few thousand dollars, should she be entitled to an earned income credit? Or should eligibility for the credit depend on combined spousal income, even though tax liability is otherwise based on individual incomes?\textsuperscript{274} The premises of separate returns—marriage neutrality and the independent
\end{itemize}

\begin{itemize}
\item \textsuperscript{266} If the husband has $38,000 of income, which puts him in the 28\% bracket, and if the wife does not work, the husband is entitled to two $2,000 personal exemptions. If the wife earns $2,000, this will shift $200 (5\% of $4,000) of personal exemptions from her husband to herself. This shift costs the husband $56 (28\% of $200), but does not benefit the wife (because her standard deduction would have sheltered her entire income). The effect is a 2.8\% tax on the wife's $2,000 earnings. Although this rate seems well within the range of tolerability, the rate would be higher if the proportionate allocation rule also caused the husband to lose part of the couple's dependency exemptions and part of their itemized deductions.
\item \textsuperscript{267} I.R.C. § 32 (West Supp. 1993).
\item \textsuperscript{268} S. REP. No. 36, 94th Cong., 1st Sess. 33 (1975), reprinted in 1975 U.S.C.C.A.N. 54, 84.
\item \textsuperscript{269} I.R.C. § 32(b)(1)(A).
\item \textsuperscript{270} Id.
\item \textsuperscript{271} I.R.C. § 32(b)(2)(A).
\item \textsuperscript{272} I.R.C. § 32(b)(1)(A).
\item \textsuperscript{273} I.R.C. § 32(b)(2)(A).
\item \textsuperscript{274} McCaffery, supra note 15, at 985-96, 1014-20.
\item \textsuperscript{275} Despite mandating separate returns for spouses, Canada provides for a child tax credit that is phased out as combined parental income exceeds a specified amount. Income Tax Act § 122.2 (1986).
\end{itemize}
economic identities of spouses—indicate she should be eligible for the credit. But the credit is intended to help the poor, and she is not poor.

There is a theoretical justification for generally separating spousal incomes while combining them for purposes of determining eligibility for the earned income credit. Part of the justification for separate returns is that liability for an income tax should be based on control of the source of the income rather than on consumption of the income, and that even if spousal income is jointly consumed, control of the source of the income is not shared.\textsuperscript{276} By contrast, the earned income credit is aimed at poverty relief, and poverty is a function of consumption rather than control of income. Thus, a control-based tax system properly keeps spousal incomes separate, while a consumption-based antipoverty program properly combines spousal incomes.

Even accepting this justification, however, the incentive effects of phasing out credit eligibility based on combined income are troubling. To simplify the calculations, imagine a 20% earned income credit on the first $5,000 of earned income (for a maximum credit of $1,000). For unmarried taxpayers, the credit is phased out at the rate of 10% as adjusted gross income exceeds $10,000 (so it is fully phased out at $20,000 adjusted gross income). Assuming separate returns are mandatory for married couples but that the phaseout of the credit is to be based on combined spousal income, how should the married phaseout be designed?

Suppose, first, that the phaseout rules are the same as for singles—phase out the credit at 10% as adjusted gross income exceeds $10,000—except that the phaseout for each spouse is determined by combining their incomes. This would result in some very large marriage penalties. Two people with $10,000 earned income each would be entitled to two $1,000 credits if unmarried.\textsuperscript{277} Married, their combined income of $20,000 would eliminate the credit for each. The marriage penalty is $2,000. In addition to appearing unfair, this may discourage marriage. Now assume a couple is already (and will remain) married, the husband earns $10,000, and the question is whether the wife should take a $5,000 job. The $5,000 earnings would generate a $1,000 credit, but the $15,000 combined income would phase out $500 of credit (10% of $5,000) for each spouse. The 20% credit is offset by the combined phaseout rate of 20%. A second

\textsuperscript{276} See supra part II.C.
\textsuperscript{277} This assumes each has enough qualifying children to obtain the same credit percentage they would obtain as a couple.
$5,000 job for the wife would generate no credit, but would phase out $500 of credit for each spouse. The effect is a 20% marginal tax rate on the second $5,000.\footnote{278} Thus, the phaseout first cancels the benefit of the wife's credit, and then imposes a high marginal rate on low levels of the wife's earnings.

A possible legislative response to these effects would be to base the phaseout on combined income, but to impose the phaseout at half the rate (and therefore over twice the range) applicable to unmarried taxpayers. The phaseout would be at 5% for each spouse, and would operate from $20,000 to $40,000 combined income. This would avoid the marriage penalty in the example above because a couple with $10,000 income each would be entitled to $1,000 credit each. It would also bring the combined phaseout rate down from 20% to the same 10% rate faced by single taxpayers. But this might extend the availability of the credit beyond what Congress would consider to be the working poor.\footnote{279} It would also produce substantial singles penalties. Two single persons with earned incomes of $20,000 and zero would be entitled to no credit; married, they would be entitled to a $1,000 credit.

In these examples the credit phaseout functions in the same way as a joint-return income tax system. The first phaseout mechanism is like a joint-return system with only marriage penalties; the second is like a joint-return system with only marriage bonuses.\footnote{280} If Congress decides to base the phaseout on combined incomes, the least objectionable approach is probably a compromise which imposes marriage penalties in some situations and marriage bonuses in others.\footnote{281}

b. \textit{If the credit is redesigned:} George K. Yin and Jonathan Barry Forman have proposed a replacing the earned income credit with a two-part program: (1) a benefit for the working poor, provided by exempting some base amount of an individual's earnings from Social

\footnote{278. This is in addition to whatever explicit tax rate applies to the second $5,000.}
\footnote{279. This objection is noted in \textit{Staff of Joint Comm. on Taxation, 96th Cong., 2d Sess., supra} note 12, at 45.}
\footnote{280. McCaffery, \textit{supra} note 15, at 996, criticizes the earned income credit phaseout rules of current law for producing only marriage penalties.}
\footnote{281. For example, the phaseout might apply at the rate of 5% to each spouse, over a combined income range of $18,000 to $38,000. Spouses with $10,000 earned income each would suffer a marriage penalty. They would be subject to no phaseout if unmarried, but with marriage each spouse's credit would be reduced by $100 (5% of $2,000). Spouses with $15,000 and $5,000 earned incomes would enjoy a marriage bonus. The higher income spouse, if unmarried, would have the credit reduced by $500 (10% of $5,000). With marriage, the combined credit reduction would be only $200.}
Security taxes and (2) a family allowance benefit, designed as a refundable credit available to any taxpayer with children living in the home, without regard to income level.\textsuperscript{282} They suggest financing the first part of their proposal by raising social security tax rates above the exemption level and financing the second part by repealing the existing dependency exemption.\textsuperscript{283} Their emphasis is on the ease of administration of their proposal as compared with the current credit.

As it happens, however, the proposal has the added attraction of fitting extremely well into a separate-return system. The first part of the proposal is simply an adjustment of the Social Security tax, which introduces modest progressivity into the system. The proposed exemption would be available to all working taxpayers, high or low income. Because this exemption functions as part of the rate structure of a tax that has always been imposed on an individual basis, it is only appropriate that it be available to a working wife regardless of her husband's income level. Thus, the first part of the proposal can and should work on a strictly separate-taxpayer basis.\textsuperscript{284} The second part of the proposal, the refundable family allowance credit, would not vary with income levels, so it would make no difference to the credit whether spousal income was combined or not.\textsuperscript{285}

The current earned income credit and a separate-return system could achieve nothing better than an uneasy coexistence. A replacement for the credit, along the lines suggested by Yin and Forman, would be much more compatible with mandatory separate returns.

V. CUTTING THE GORDIAN KNOT: AN ASIDE

Although it is impossible to have marriage neutrality, couples neutrality, and progressive \textit{marginal} tax rates, commentators have described two systems which could achieve both neutralities and progressive \textit{effective} tax rates. Since these systems appear to offer a way out of the dilemma, they merit examination.

\textsuperscript{283} \textit{Id.} at 958-59.
\textsuperscript{284} This is how Yin and Forman propose the exemption would operate. \textit{Id.} at 958.
\textsuperscript{285} There could be a problem, however, with allocating \textit{children} between spouses for purposes of the credit, if the amount of the credit is not determined on a simple dollars-per-child basis. If, for example, one child generated more than half the credit of two children, could each spouse of a two-child family claim a credit based on the one child amount? Probably children of the couple should be aggregated, so the couple would be entitled to one two-child credit, rather than two one-child credits.
The first system, which has been described by Michael C. Lovell,²⁸⁶ combines a negative income tax and a flat rate tax. The negative income tax is a refundable per person credit of some fixed dollar amount. It is a cash grant from the government awarded simply for existing, administered through the tax system. Suppose, for example, the per person credit is $3,000 and the flat rate tax on income is 30%. A person with no income would receive $3,000 from the government (infinitely negative effective tax rate); a person with $10,000 income would have no payment to or receipt from the government, because the $3,000 credit would cancel out the $3,000 tax (zero effective tax rate); a person with $20,000 income would have $6,000 tax and a $3,000 credit, resulting in a net payment of $3,000 (15% effective tax rate); and a person with $30,000 income would have $9,000 tax and a $3,000 credit, for a net payment of $6,000 (20% effective tax rate). As income increases, the effective tax rate approaches (but never quite reaches) 30%.

The example demonstrates that this system would have some progressivity in its effective tax rates. It would be administered on a separate-return basis, so it would be marriage neutral. It would also be couples neutral: Any couple with $X combined income will pay tax (or receive a credit) equal to ($X)30% - 2($3,000), regardless of how the income is distributed between the spouses.

The other solution to the marriage tax dilemma is suggested by Charles R. O’Kelley, Jr.²⁸⁷ He proposes a separate-return system with a large personal exemption ($10,000) and a flat tax rate (30%) above the exemption level. The personal exemption creates some effective rate progressivity, and the use of separate returns (with nontransferable personal exemptions) makes the system marriage neutral. Such a system would not, however, appear to achieve couples neutrality because a two-earner couple would have the benefit of two personal exemptions while a one-earner couple would have only one exemption. For example, spouses with $50,000 income each would have combined taxable income of $80,000, but a husband with $100,000

²⁸⁶ Michael C. Lovell, On Taxing Marriages, 35 Nat’l Tax J. 507 (1982). This possibility is also noted in Staff of Joint Comm. on Taxation, 96th Cong., 2d Sess., supra note 12, at 26-27: “A system with a flat tax rate and a per taxpayer refundable credit would have marriage neutrality, equal taxation of couples with equal incomes and some limited progressivity.”
income and a wife with zero income would have combined taxable income of $90,000.288

O'Kelley solves this problem, however, by requiring that the non-earning spouse include $10,000 imputed income from homemaking services in her taxable income.289 Since this amount is then offset by the wife's personal exemption, this rule has the same practical effect as simply denying (to either spouse) a personal exemption for a non-earning spouse.290 Despite its lack of any practical effect, however, the imputed income move is crucial to O'Kelley's approach because it enables him to claim that his system achieves couples neutrality. Thus, the fact that the couple with earned incomes of $100,000 and zero pays more tax than the couple with two $50,000 earned incomes does not violate couples neutrality because the former couple has more income, taking imputed income into account. That couple actually has $110,000 total income, and so it appropriately pays the same tax as a two-earner couple with incomes of $50,000 and $60,000 (or any other combination totalling $110,000).

Although both solutions to the dilemma are interesting and creative, they are both subject to important objections. First, because they both rely on differences in effective rates (rather than on differences in marginal rates) to achieve progressivity, their progressivity potential is limited. The force of this objection depends, of course, on whether one wants more progressivity than these approaches can deliver.

The other objections relate to the special features of each system. A negative income tax would be a radical innovation. In the 1970s it received serious attention, but experiments in Seattle and Denver revealed major problems and it has never regained favor.291 Even in

288. This could be avoided by allowing the transfer of the wife's personal exemption to the husband, but that would violate the principle of marriage neutrality.

289. O'Kelley uses the $10,000 figure in his examples, for both the personal exemption amount and the imputed income amount. Actually, he would set both these amounts equal to the minimum wage. O'Kelley, supra note 287, at 744-51, 764.

290. O'Kelley does not explain how his system would treat a spouse who earns something, but less than $10,000. The logic of his approach is clear, however. If a wife earns, for example, $6,000, she would be treated as having imputed income of $4,000 (the excess of $10,000 over $6,000), and again her taxable income and personal exemption would cancel each other out.

the unlikely event that the country is ready to accept a negative income tax, there is the conceptual question of whether a per capita cash grant from the government is really part of the income tax system. It is necessary to think of the cash grants as part of the income tax system in order to view the system as progressive. But it is at least as plausible to view the per capita cash grant as a sort of welfare program that happens to be administered by the IRS, but really has nothing to do with the positive income tax.

The O'Kelley proposal is as much sleight of hand as it is a real solution to the dilemma. It does not achieve couples neutrality in the conventional sense. It achieves couples neutrality only with the invocation of imputed income. Because the same practical results as the O'Kelley proposal could be reached more simply with no mention of the concept of imputed income, O'Kelley's use of the concept is rhetorical rather than substantive. A system with the effect of O'Kelley's can be described as taxing imputed income and having couples neutrality, or as not taxing imputed income and not having couples neutrality. Under O'Kelley's view of good tax policy, the former description is more appealing. I doubt if the American public would agree.

There is an old joke about a man who tries on a suit a tailor has made for him. He notices one arm of the jacket is too short, but the tailor explains that no one will notice the defect if he holds his arm at an awkward angle. The story continues with the customer finding half a dozen additional defects, which the tailor solves with half a dozen additional suggested contortions. As the man hobbles out of the shop he is seen by two passers-by. The first says, "That poor guy looks terrible," and the second replies, "Yeah, but what a great-fitting suit." The proposals to solve the income tax's marital dilemma are reminiscent of that joke. If one likes having no marginal rate progressivity and having either a negative income tax or a tax on imputed income (rhetorically, at least), then the solution to the marital dilemma is a nice bonus. But if one dislikes these features and adopts them only because they offer a way out of the marital dilemma, one is like the man in the suit. "That income tax system looks terrible." "Yeah, but what a great solution to the marital dilemma."

VI. CONCLUSION

There is no absolutely right or wrong way to tax married couples. A system that is right for one time and place may be wrong for
another. Whatever the merits of joint returns may have been for mid-
twentieth century America, the joint-return system fits poorly with
American attitudes and living patterns at the close of the century.
The difficult question is when the dissatisfaction will become so great
as to overcome the inertia of present law. The answer will depend
partly on developments external to the tax system—the evolution of
social attitudes and behaviors. It may also depend, however, on the
degree of progressivity of the income tax: The more progressive the
tax, the larger the marriage penalties and the greater the discouragement of working wives. Increases in the progressivity of the tax will hasten the demise of joint returns. But assuming an income tax with any significant amount of progressivity, the joint return will eventually disappear—the only question is when.