Federal Income Taxation and the Family*

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A persistent problem in the theory of income taxation is whether natural persons should be taxed as isolated individuals, or as social beings whose family ties to other taxpayers affect their taxpaying capacity. From its inception, the federal income tax law has permitted every taxpayer to file a personal return, embracing his or her own income but excluding the income of the taxpayer’s spouse, children, and other relatives. On the other hand, married couples may elect to consolidate their income on a joint return, many exemptions and deductions take account of family links and responsibilities, and the income or property of one member of a family is sometimes attributed to another member for a variety of tax purposes. The Internal Revenue Code, in brief, is a patchwork, its history being a myriad of compromises fashioned to meet particular problems.

While this tension between rugged individualism and family solidarity permeates the entire Code, four broad questions capture the major themes:

—Should family members—husbands, wives, children, or others—be required, allowed, or forbidden to amalgamate their separate incomes in order to compute a joint tax liability?

—If amalgamation is either permitted or required, what should be the relationship between the tax liability of a family on its amalgamated income and that of a person living outside any family unit on his or her individual income?

—Should the taxpayer—whether an individual or a family entity—receive a tax allowance for supporting children, parents, or other relatives?

—How should the tax law treat transfers, sales, and other financial and property arrangements between family members, and for what tax purposes (if any) should the law attribute the income or property of one family member to another?

The responses of today’s law to these questions are, of course, influenced by the need for revenue, by the Internal Revenue Service’s capacity to audit

returns and enforce the rules, by legislative and administrative efforts to minimize inconsistencies within the statute and regulations, and by other objectives, constraints, and values that are "internal" to the tax system. But the impact of these factors on Congress, the Treasury, and the public has always depended on a much more influential context—society’s assumptions about the role of marriage and the family.

We are living in a period of unprecedented debate about the status of marriage and the family. Citizens, moral philosophers, political groups, legislators, and judges are questioning many traditional legal distinctions between men and women, between informal alliances and ceremonial marriage, between legitimate and illegitimate children, between the role of the family and the role of the state, and between the power of parents and the rights of children. In such an era, it is fatuous to expect the premises underlying the Internal Revenue Code to escape inquiry or to suppose that income taxation has a "logic" of its own capable of supplying certitudes to a society wracked by doubts.

For these reasons, the Internal Revenue Code's current answers to the questions set out above are ripe for reexamination. The goal of this Essay is to examine the theories and pressures that shaped today's Internal Revenue Code and to suggest how its provisions may fare in the maelstrom of changing social attitudes toward marriage, women's rights, the two-job couple, communal living patterns, birth control, population growth, and intrafamily rights and liabilities. I hope this will be a useful inquiry, despite the paucity of confident answers and the certainty that any tax reforms spawned by today's social trends will be as particularistic and transitory as the laws they supplant.

I. Consolidation of Family Income

A. Theoretical Considerations

1. The case for consolidation.

By and large, tax theorists have espoused the doctrine "that taxpaying ability is determined by total family income regardless of the distribution of such income among the members of the family," rather than the contrary theory "that the family as a unit has no combined taxpaying ability per se; that its taxpaying ability is composed of the separate taxpaying abilities of its individual members; and that the taxpaying ability of each of these is determined by the amount of income of which he or she is the owner without reference to the income of the other members of the fam-
The philosophy of consolidation was recently championed in an influential report by the Canadian Royal Commission on Taxation. Its legislative proposals in this area were not enacted, but the Commission's statement in favor of consolidating family income is an excellent exposition of the social premises that underlie this position:

We conclude that the present [Canadian tax] system is lacking in essential fairness between families in similar circumstances and that attempts to prevent abuses of the system have produced serious anomalies and rigidities. Most of these results are inherent in the concept that each individual is a separate taxable entity. Taxation of the individual in almost total disregard for his inevitably close financial and economic ties with the other members of the basic social unit of which he is ordinarily a member, the family, is in our view [a] striking instance of the lack of a comprehensive and rational pattern in the present tax system. In keeping with our general theme that the scope of our tax concepts should be broadened and made more consistent in order to achieve equity, we recommend that the family be treated as a tax unit and taxed on a rate schedule applicable to family units. Individuals who are not members of a family unit would continue to be treated as separate tax units and would be taxed on a schedule applicable to individuals.

We believe firmly that the family is today, as it has been for many centuries, the basic economic unit in society. Although few marriages are entered into for purely financial reasons, as soon as a marriage is contracted it is the continued income and financial position of the family which is ordinarily of primary concern, not the income and financial position of the individual members. Thus, the married couple itself adopts the economic concept of the family as the income unit from the outset. In western society the wife's direct financial contribution to the family income through employment is frequently substantial. It is probably even more true that the newly formed family acts as a financial unit in making its expenditures. Family income is normally budgeted between current and capital outlays, and major decisions involving the latter are usually made jointly by the spouses.

Where the family grows by the addition of children, further important financial and economic decisions are made in the family as a unit. Questions of the extent of education, time of entrance into the labour force and, frequently, choices of a career are decided on a family basis, although of course there are many exceptions to this statement. In some circumstances the income of the child is added to the family income, and, even where this is not done directly, the fact that a child has income of his own will have some bearing on the main family expenditure decisions. Certainly when the child becomes self-supporting he is nor-

2. Treasury Department, supra note 1, at 851. For citations to the comments of tax theorists, of whom very few have favored basing tax liability on individual income, see Thorson Dissertation, supra note 1.

mally expected to relieve the family of further expenditure on his behalf. Thus, the income position of children has an important bearing on the family income, although frequently in an indirect way.4

This rationale implies that the tax on a family with a given amount of consolidated income should be the same regardless of the proportion of each spouse's contribution to their total income,6 and it also suggests, though less clearly, that the ratio of parent-child contributions should also be irrelevant. A corollary of this emphasis on the family's consolidated income is that legal ownership of property and income within the family should be disregarded in judging its taxpaying capacity. For at least 50 years, a major theme in the taxation of income from property transferred within the family has been that bedchamber transactions are suspect because the allocation of legal rights within the family is a trivial matter.6

But the persons concerned may have a less cavalier attitude toward their legal rights. Taxpayers pass up many opportunities to reduce their taxes by intrafamily gifts,7 possibly from ignorance or inertia, but perhaps because they attach more significance to their legal rights than academicians assert. The contemporary women's rights movement is a reminder of the long struggle for married women's property laws, whose underlying premise was that the division of legal rights between husband and wife is a significant matter, not a trivial one. Of course, the legal recognition of the property rights of married women may have brought with it, or resulted from, a fundamental change in matrimonial psychology, causing the legal rights acquired by the wife to be as irrelevant as those retained by the husband, at least while the marriage lasts. But it is far from self-evident that the property rights won by married women are inconsequential. Moreover, at least among upper-income taxpayers, it is not uncommon for separate accounts to be maintained for property owned by each spouse at the time of the marriage, inherited thereafter, or accumulated from earnings or household allowances, especially if the household includes children of a prior marriage. It may be, therefore, that tax theorists have excessively downgraded the importance of legal rights within the family, and that a swing of the pendulum is in the offing.

4. 3 REPORT OF THE ROYAL COMMISSION ON TAXATION, supra note 3, at 122-24.
5. For the special case of the two-job married couple, see notes 117-45 infra and accompanying text.
6. A representative illustration of this theme, which was accepted by judges with the same enthusiasm as by tax theorists and administrators, is Helvering v. Clifford, 309 U.S. 331, 335 (1940): "We have here at best a temporary reallocation of income within an intimate family group. ... It is hard to imagine that respondent [the transferor] felt himself the poorer after this trust had been executed or, if he did, that it had any rational foundation in fact." Of course, this conclusion may well have been justified, but despite its tough realism, transfers with no strings attached have been customarily accepted at face value, even though the transferor might feel no poorer after making a gift "within an intimate family group."
Since 1948, however, the Internal Revenue Code has imposed the same liability on all equal-income married couples, whether the combined income is generated by the earnings or investments of one spouse or both and without regard to the division of ownership between them. So long as family harmony prevails, equal-income married couples can purchase equal quantities of goods and services and probably make their economic decisions in a substantially identical fashion. These common characteristics have been regarded by most theorists as more important in fixing the tax liability of equal-income married couples than differences in their ownership of property, even though technical ownership may become crucial if the marriage is dissolved. For this reason, the 1948 statutory principle of equal taxes for equal-income married couples has been “almost universally accepted” by tax theorists, except for suggestions that a two-job married couple should not pay as much as a one-job married couple with the same joint income.

2. Tax-equality or marriage neutrality?

There is, however, a cloud on the horizon. It is increasingly argued that the income tax on two persons who get married should be neither more nor less than they paid on the same income before marriage. This call for a marriage-neutral tax system stems sometimes from the conviction that the state should neither encourage nor discourage marriage by a tax incentive or penalty, and sometimes from a belief that ceremonial marriages in today’s society are not sufficiently different from informal alliances to warrant a difference in tax liability. A legislative bill to achieve a marriage-neutral federal income tax has gained a large and diverse Congressional following in both the House of Representatives and the Senate. Proponents of this reform, however, often overlook the fact that, given a progressive rate schedule, a marriage-neutral tax system cannot be reconciled with a regime of equal taxes for equal-income married couples.

This collision of objectives is easily illustrated. If we assume a rate schedule taxing single persons at the rate of 10 percent on the first $10,000 of income and 25 percent on amounts above $10,000, the taxes paid by four unmarried persons on the amounts of taxable income set out in Table 1 would be as shown therein.

If Alpha marries Beta and Theta marries Zeta, and all four continue to earn the same amount of income as before marriage, the consolidated

9. See notes 117–125 infra and accompanying text.
income of each married couple will be $20,000. If their marriage is to have no effect on their tax liabilities, Alpha-Beta should continue to pay a total of $2,000 and Theta-Zeta a total of $2,900 in taxes. But if this difference in their tax burdens is deemed to be unwarranted, and a new rate schedule is prescribed for married couples that will cause Alpha-Beta and Theta-Zeta to pay the same tax since they have the same joint income ($20,000), marriage will either (1) decrease the tax burden for both couples, (2) decrease it for one and leave the other’s unchanged, (3) decrease it for one and increase it for the other, (4) increase it for one and leave the other’s unchanged, or (5) increase it for both—depending on the rate schedule applicable to married couples. In tabular form, using the couples described in Table 1, these possibilities are as shown in Table 2.

In short, we cannot simultaneously have (a) progression, (b) equal taxes on equal-income married couples, and (c) a marriage-neutral tax burden.11 A corollary of this conclusion is that a tax system with a progressive rate schedule can be marriage-neutral if individual legal rights over income and property are controlling even after marriage and each spouse reports his or her own income, but not if the tax is based on the couple’s consolidated income.

For these reasons, advocacy of a marriage-neutral tax system collides directly and irretrievably with a dominant theme of tax theory for at least 50 years—the irrelevance of ownership within intimate family groups. This principle, together with its implication that taxing capacity is best measured by consolidated marital or family income, not only has been regularly expounded in the scholarly literature and preached in the classroom, but also has been a major influence on Congress and the judiciary. As will be seen, however, these ideas at one time had powerful challengers, who may belatedly come to be honored as unsung heroes if today’s advocates of a marriage-neutral tax system carry the day.

11. It should be noted that this dilemma, as demonstrated by Table 2, arises even when two-job married couples are compared with each other; it is not restricted to the effect of marriage when only one spouse is gainfully employed outside the home.
TABLE 2

Effect of Marriage on Taxes

<table>
<thead>
<tr>
<th>If the Tax on Married Couples with $20,000 of Taxable Income Is:</th>
<th>Marriage Will Have the Following Effect on the Tax Burden Shown in Table 1:</th>
<th>Alpha-Beta</th>
<th>Theta-Zeta</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Less than $2,000</td>
<td>Decrease</td>
<td>Decrease</td>
<td></td>
</tr>
<tr>
<td>2. $2,000</td>
<td>No change</td>
<td>Decrease</td>
<td></td>
</tr>
<tr>
<td>3. More than $2,000 but less than $2,900</td>
<td>Increase</td>
<td>Decrease</td>
<td></td>
</tr>
<tr>
<td>4. $2,900</td>
<td>Increase</td>
<td>No change</td>
<td></td>
</tr>
<tr>
<td>5. More than $2,900</td>
<td>Increase</td>
<td>Increase</td>
<td></td>
</tr>
</tbody>
</table>

3. The income of children.

Returning to the Canadian Royal Commission's rationale for taxing families on their consolidated income, it will be recalled that the Commission advocated consolidation of the income of children as well as the income of spouses. In a society whose children are expected to work and to contribute their earnings to the family pool without voicing any opinions on the way funds are used, the case for consolidation is strongest. But even in a society that accords more financial independence to children, their earnings affect the economic behavior of the parents; as the children's income grows, the parents are relieved of pressure to support the children currently and to pass on an inheritance to them. The larger the aggregate pool of resources, it is argued, the greater the group's capacity to pay taxes.

The theory is not without appeal. But the justification for consolidating family income is not "tax logic," or any other factors peculiar to the tax system, but rather a social phenomenon—more precisely, the observer's perception of social realities. The Canadian Royal Commission itself implicitly acknowledged this by proposing a series of limits to the inclusion of children's income in the family's consolidated tax base. First, consolidation was to be compulsory only if the children were minors or disabled. Other children, whether living with their parents or not, were excluded, except that students between 21 and 25 years of age could elect to have their income included in the family tax base. Moreover, minors over the school-leaving age could elect to be excluded if employed and living apart from their parents. Finally, regardless of a child's age, gifts and bequests received by him (which were to be included in taxable income under another Commission proposal) could be deposited in an "Income Adjustment Account," a quasi-trust device for holding the property intact until the child's de-
parture from the family unit (usually at 21) and taxing the accumulated income to him at that time. This exception to consolidation was evidently confined by the Commission to property acquired by gift or bequest in the belief that such property is more likely to be treated as sacrosanct by the parents than would be the child's personal earnings. If so, we have one more illustration of the pervasive influence of social customs—actual or perceived—on the tax system.

These exceptions to the principle of consolidation acknowledge that children should eventually be regarded as autonomous persons whose tax-paying capacity is independent of their parents. Other draftsmen might draw the line elsewhere, but presumably even the most committed proponent of consolidation would abandon it at some point—whether it be when children reach 18 or 21, become self-supporting, leave the parents' home, get married, or have children of their own.

4. Defining the group whose income is to be consolidated.

If income is to be consolidated, the entity subject to this treatment must be defined, e.g., "married couple," "family," "household," etc. Sociologists may find it useful to study groups that engage in joint decisionmaking or that manifest a common interest in the economic well-being of their members, but it would be difficult if not impossible to administer a law that employed such squishy phrases. Any more precise definition, however, will inevitably exclude groups that are only marginally different, so far as relevant economic or social relationships are concerned, from those within the magic circle. If married couples are taxed on their consolidated income, for example, should the same principle extend to a child who supports an aged parent, two sisters who share an apartment, or a divorced parent who lives with an adolescent child? Should a relationship established by blood or marriage be demanded, to the exclusion, for example, of un-

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14. In recent years draftsmen and administrators of social welfare programs have wrestled continually with the problem of defining family and household units. See, e.g., United States Dept of Agriculture v. Moreno, 413 U.S. 528 (1973), where a statute that defined a household eligible for federal food stamps as "a group of related individuals, who . . . are living as one economic unit sharing common cooking facilities and for whom food is customarily purchased in common" was held to be unconstitutional as a discrimination against households containing unrelated individuals. See also Hurley v. Van Lare, 380 F. Supp. 167 (S. & E.D.N.Y. 1974) (reduction of welfare allowance based on presence of a "lodger" in household is unconstitutional); Klein, supra note 1, at 388 (discussing constitutionality of statutory rules based on the permanence of a sexual liaison between two unmarried persons, describing the California concept of a "man assuming the role of spouse" ("MARS"), and referring to "spouselike persons"); Lerman, The Family, Poverty and Welfare Programs: An Introductory Essay on Problems of Analysis and Policy, in SUBCOM. ON FISCAL POLICY OF THE JOINT ECONOMIC COMM., 93d CONG., 2d Sess., Studies in Public Welfare, Paper 12, Part I, The Family, Poverty, and Welfare Programs: Factors Influencing Family Instability (Comm. Print 1974).

For discussions of the relationship of family and household patterns to public welfare programs, see id., pt. II, at 181.
married persons who live together, homosexual companions, and
communes?

The most objective boundary lines are those based on legal character-
istics such as marital status, obligation to support, or right to inherit. Under
existing law, the principal determinant of the tax burden is marriage, a
status that is usually unambiguous. In a society that increasingly questions
the legitimacy of traditional legal distinctions, however, one is tempted to
substitute social "realities" in defining the boundaries of the group whose
income is to be consolidated. But every departure from readily established
definitional lines increases the problem of enforcement. If the tax on two
unmarried persons depends on whether they live together, for example,
how is their status to be verified by the Internal Revenue Service without
an intolerable intrusion into their private lives? The attempt of social
workers to apply the "man in the house" rule to deny welfare payments
suggests the difficulties that would be encountered by the Internal Revenue
Service in auditing claims that taxpayers are, or are not, living together.
If the assertions of status on tax returns were taken at face value in order
to minimize or eliminate costly and abrasive investigations, the revenue
loss resulting from improper claims might be very large; perhaps more im-
portant, conscientious taxpayers would be offended by the government's
refusal to enforce its own rules against others. For these reasons, it does not
seem feasible to consolidate the income of a group unless its boundaries
can be crisply defined and readily verified.

B. The Realm of Practice—1913 to 1948

Turning from theory to practice, we find that the tension between the
"individual" and "family unit" approaches to federal taxation has had a
tortuous history since 1913, when the sixteenth amendment was ratified.
The twists and turns in legislative, judicial, and administrative practices
provide abundant evidence of the inevitable conflict of values that attend
any statutory decision in this area. So much light is cast on current issues
by this history that an examination in moderate depth of the principal lines
of development is warranted, if not unavoidable.

15. The principal source of ambiguity in ascertaining marital status is an out-of-state divorce of
debatable validity. See, e.g., Estate of Borax v. Commissioner, 349 F.2d 666 (2d Cir. 1965), cert.

16. In Sweden, we are told, the social and legal lines between marriage and informal cohabita-
tion have become quite hazy, but unmarried persons who live together are treated as a tax unit only
if they were previously married (in which event the dissolution of their marriage is a suspect "tax
divorce") or have borne children. See Sundberg, Marriage or No Marriage: The Directives for the
Revision of Swedish Family Law, 20 INT'L & COMP. L.J. 223 (1971). To aid the enforcement of these
provisions, Swedish taxpayers must state annually in their tax returns whether they are living with
another person. See id. at 223.

17. See note 14 supra.
i. The early statutes and the courts: Lucas v. Earl.

Despite the all but universal preference of theoreticians for the consolidation of family income, the tax legislation enacted by Congress was dominated by an individualistic approach at the outset. This focus on individuals rather than married couples, families, or households was implicit as early as 1913, when the introductory words of the first taxing statute based on the sixteenth amendment imposed a tax "upon the entire net income arising or accruing from all sources . . . to every citizen of the United States . . . and to every person residing in the United States, though not a citizen thereof." The Revenue Act of 1916 made the point explicit by taxing "the entire net income received . . . by every individual." The right of married couples to file a joint return (first recognized by statute in 1918) was not an exception to this individualistic bias, since the same rate schedule applied to both separate and joint returns, with the result that joint filings were disadvantageous except in unusual circumstances.

This early Congressional decision to tax individuals rather than families was buttressed by a series of judicial decisions—whose importance in the development of the federal tax system can hardly be exaggerated—holding that a taxpayer who earns or is otherwise entitled to receive income cannot assign it, for tax purposes, to another taxpayer, even if the transfer is effective under state law. The leading case, Lucas v. Earl, involved an agreement between husband and wife for an equal division between them of all earnings, investment income, gifts, and other receipts during their marriage. The agreement was executed in 1901 and hence was innocent of a tax avoidance objective. Despite this, the Supreme Court held in a much-quoted opinion by Mr. Justice Holmes that the husband was taxable on the full amount of his personal service income:

[T]his case is not to be decided by attenuated subtleties. It turns on the import and reasonable construction of the taxing act. There is no doubt that the statute

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20. A joint return could increase a generous couple's deductions for charitable contributions by increasing their adjusted gross income and hence raising the deduction ceiling which is determined by a percentage of adjusted gross income. See also Helvering v. Janney, 311 U.S. 189 (1940) (capital losses of one spouse deductible from capital gains of other spouse in computing "aggregate income" on pre-1948 joint return).
22. 281 U.S. 171 (1930). The taxpayers were domiciled in California; however, during the taxable years involved, the California community property system did not confer a sufficient interest on the wife to permit her to report half the husband's earnings on her separate return. See note 44 infra and accompanying text.
could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew.  

Under Lucas v. Earl, it became virtually impossible for a taxpayer with income from wages, salaries, or professional fees to shift these items to other taxpayers such as a spouse or child.

But dividends, interest, rents, and other forms of investment income were affected very differently by Lucas v. Earl than income from personal services. The "tree" (to use Justice Holmes' metaphor) that produces investment income, according to the courts, was the underlying property itself, so that the income is taxable to the person owning the property when the income arises. Thus, taxpayers wanting to shift the tax liability for investment income to their spouses or children found it possible to do so with impunity, if they were prepared to give up ownership of the underlying securities, bank account, rental real estate, or other property. In essence, legal ownership of the property came to be controlling, no matter how strong the emotional ties between the donor and donee.

2. What might have been: a tax world without Lucas v. Earl?

The opinion in Lucas v. Earl is late-vintage Holmes, magisterial in tone, studded with quotable phrases, and devoid of analysis. It is by now so entrenched in the thought of tax experts that an income tax system without Lucas v. Earl is hard to imagine, rather like envisioning the English language without Shakespeare or the King James translation of the Bible. But the effort is worth making, since it will help to expose some half-hidden premises in the tax treatment of family income.

What if the Supreme Court had thought that the language of the statute and the "intent" of Congress, both murky at best, required the husband-wife agreement (whose validity in determining their property rights under state law was acknowledged) to be honored for tax purposes as well? Assuming Congressional acquiescence in this result, married couples would then have been able to split their income for both private and tax purposes,

24. If a taxpayer balked at a complete divestiture of ownership, a partial transfer would sometimes suffice. The tortuous and often hazy statutory, judicial, and administrative boundaries between effective and ineffective transfers are, of course, a major subject of inquiry in law school courses in federal income taxation.
and all equal-income married couples making this election would have paid the same amount of federal income taxes. As an objective of federal tax policy, this result of equal taxes on equal-income married couples has been widely approved by tax theorists, yet the effort of Mr. and Mrs. Earl to achieve a tax burden that was independent of their proportionate contributions to their joint income was repulsed by *Lucas v. Earl*, and generations of law students have been led to applaud the decision.

Mr. and Mrs. Earl were prophets without honor in another respect. By establishing for themselves a marital regime of equal ownership and equal control of their joint income in 1901, they foreshadowed an idea that contemporary women's rights advocates often present as novel, and that many regard as worthy of being imposed by law on all married couples. Moreover, it was only by equalizing their financial positions that they put themselves in a position to claim the tax advantage of equal-income separate returns. Though their tax claim was rejected, the income-splitting joint return authorized by Congress in 1948, which with only minor changes is still in effect, achieves the tax result that Mr. and Mrs. Earl were seeking. It does so, however, without requiring husband and wife to equalize their ownership *inter se*; in this respect, the Earl agreement might be regarded as an improvement over the 1948 statutory reform. In retrospect, therefore, it is not fanciful to suggest that the taxpayers in *Lucas v. Earl* might well have been praised for an agreement embodying a sound principle of marital partnership that, had it been upheld, would have furthered an equally sound principle of tax law, instead of being castigated for seeking refuge in what Mr. Justice Holmes called "attenuated subtleties."

The Supreme Court is nothing if not supreme, however, and the Holmsian epigrams in *Lucas v. Earl* carried the day. The propriety of the decision became an article of faith with tax theorists, and it soon was regarded as a guardian of the progressive rate structure. In fact, however, the judgment of the court of appeals, which was reversed by the Supreme Court, was equally compatible with any desired degree of progression. To illustrate this point, assume a rate schedule that exempts the first $100,000 of income and taxes all income above that level at 100 percent. Under *Lucas v. Earl* as decided, a married breadwinner would become subject to the 100 percent rate as soon as his or her salary exceeded $100,000, which is the same point at which a single person would become subject to the 100 percent rate. Had

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26. See note 8 supra and accompanying text.

27. For proposals to accord federal tax effect to "marital partnerships" established by married couples in common law states to create property rights similar to those arising in community property states, see H.R. 3842, 80th Cong., 1st Sess. (1947), reprinted in *Hearings on Revenue Revisions Before the House Comm. on Ways & Means*, 80th Cong., 1st Sess., 762 (1947); Altman, *Community Property: Avoiding Avoidance by Adoption in the Revenue Act*, 16 *TAXES* 138 (1938).

28. I do not exculpate myself for worshiping false gods.
Lucas v. Earl gone the other way, a married couple would become subject to the 100 percent rate only if their aggregate income exceeded $200,000; the first $200,000 would be exempt, but this is the same amount that two single persons could enjoy tax-free if each had a salary of $100,000.

Which approach serves the cause of progression better depends on one's views about the relationship between a married couple's tax burden and the tax burden of single persons with the same amount of income. If the best reference point is the tax paid by two single persons of whom one has the same income as the husband and the other the same income as the wife—the Lucas v. Earl result—then that case "protects" the progressive rate schedule. But if the married couple's taxing capacity is more nearly comparable to that of two single persons each with one-half their income, Lucas v. Earl makes no contribution to—indeed, interferes with—the achievement of progression. There is nothing in the principle of progression that requires taxing capacity to be determined by looking to the source of income, in disregard of the fact that it is shared by a married couple or family. For this reason, the common notion that the principle of Lucas v. Earl, as applied to married couples, was an essential buttress to the progressive rate schedule is fallacious.

A final aspect of Lucas v. Earl's exaggerated reputation as a guardian of progression has served to obscure its responsibility for an objectionable distinction between earned and investment income. When Lucas v. Earl was decided, it was already established law that taxpayers with investment income could make intrafamily gifts that would be effective in computing their federal tax liability, if they were willing to relinquish control over the underlying income-producing property. Against this background, Lucas v. Earl imposed a disability on wage earners and salaried taxpayers that cannot be easily reconciled with a concern for progression. To the contrary, if income splitting had been made as freely available to them as to taxpayers with investment income, the result would have been a tax structure whose progressive rates—at whatever level Congress chose to fix them—would have applied more equitably as between married couples with earned income and married couples with an equal amount of investment income. This disparity between earned and investment income persisted until the enactment in 1948 of the income-splitting joint return.

29. As applied outside the family context (e.g., to prevent the shifting of income from a taxpayer to trusts, corporations, or other entities in which he has a beneficial interest), however, Lucas v. Earl clearly serves to protect progressivity.
30. See note 24 supra and accompanying text.
31. Sole proprietors and partners in business firms, whose personal service income is mingled with income from invested capital, are less restricted by Lucas v. Earl. Despite its rejection of "attenuated subtleties," the decision did not automatically negate the effectiveness of partnership and close corporation arrangements between taxpayers active in the business and their spouses or children, and these devices are often honored by the Internal Revenue Service and the courts.
Finally, in retrospect one can discern still another irony in *Lucas v. Earl*. In holding that the marital partnership established by Mr. and Mrs. Earl was an "anticipatory arrangement" that for tax purposes could not be allowed to override the fact that under private law the husband's salary vested in him as soon as the services were performed, it simply gave precedence to one "anticipatory arrangement" (the employer-employee contract) over another (the husband-wife contract), on the ground that the first had taken hold an instant before the second. This may have been a reasonable reading of a murky statute, but in making policy, there is no valid reason to allow the time when their legal rights vested to determine whether the husband or the wife should be taxed on the income in question. Moreover, although *Lucas v. Earl* did not explicitly denigrate the husband-wife contract as a "bedchamber" reshuffling of legal rights, it was taken to imply that such arrangements should be viewed with suspicion because legal rights within the family unit are inconsequential. But if their reshuffling of legal rights is to be disregarded, why attach any greater importance to the original division of ownership between husband and wife? Should not equal-income couples pay the same tax, regardless of how their legal rights are originally allocated or subsequently rearranged between them? Congress answered this question in the affirmative in 1948, and the seeds of this legislative decision were buried in *Lucas v. Earl*, even though it held that the statute before it required a negative answer to the same question.


Individualism thus came to reign supreme in the formative years of federal income taxation in the sense that every individual was taxed on his or her "own" income. In states with a common law property system, the result was that the taxes paid by married couples with equal amounts of aggregate income varied greatly, depending on whether their investment income was divided between them or not and, in the case of personal service income, on whether there was one breadwinner or two. In the community property states of the Southwest and Pacific Coast, however, where marriage is treated as a partnership that vests in each spouse a present interest in one-half of the couple's joint income, whether derived from personal services or from their community property, tax equality of equal-income married

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32. This reading of *Lucas v. Earl* is confirmed by the same Court's unanimous decision in *Poe v. Seaborn*, 282 U.S. 101 (1930), that the husband's earnings in a community property state are, in effect, already subjected to the wife's one-half interest when the salary is paid to him. In a community property state, in other words, the marriage agreement causes the wife's rights to vest before the salary is paid, and any contrary employer-employee agreement comes too late; in a common law state, the husband-wife and employer-employee contracts are given just the opposite order of precedence.

33. See note 6 supra.
couples came to be the prevailing principle. But this result was reached only after the Treasury and the courts fumbled uncertainly for many years with the proper treatment of community income. Were wages, for example, to be reported by the wage earner, or one-half by each spouse? If personal service income was invested, who should report the subsequently received dividends, interest, and rents? These questions first arose in 1913, but they were not definitively answered until 1930, when the Supreme Court held in Poe v. Seaborn that each spouse was taxable on one-half of the community income.

Until then, the Treasury had to fend for itself in administering a taxing statute that referred vaguely to “the net income of each individual” but that had to be applied in states whose community property systems give the wife a “present interest” in one-half of the community income, but vest the husband with the exclusive right to manage the property free from any duty to account for his stewardship while the marriage lasts. His managerial powers amount to something less than full ownership of the community income, of course, but even in common law states the husband’s “own” income is burdened by legal restrictions, including a duty to support his wife during marriage, make proper provision for her on divorce, and transfer a specified part of his estate to her if she survives him.

When debating the tax significance of these legal differences between the community property and common law systems, the commentators were usually overwhelmed by their own rhetoric. Thus, the community property system was extolled as “a heritage of the great free peoples,” to be contrasted with a common law system that treated women as “inferior beings, entitled only to a subordinate place in the social order” and that owed its origin “to the fact that Scandinavian pirates, descending on the coasts of France, adapted to their use a code of marital property laws deemed appropriate to the daughters of the vanquished” and then imposed it on the English after the Norman Conquest. Denying that this contrast between civilization and barbarism is helpful in creating a tax structure for the twentieth century.

34. Local law left room for “separate” income, which was taxable to one spouse or the other in the same way that he or she would be taxed in a common law state, but these items (e.g., income excluded from the community by agreement between the spouses, and some receipts during marriage that under state law did not become community income) were ordinarily of minor importance.

35. The question could also have arisen under the Civil War and 1894 Income Tax Acts which were based on individual income, see note 19 supra, but the modest rates made the issue rather unimportant.


38. These gender-based obligations may now or in the future be matched by correlative obligations on the wife but they were unique to the husband during the period under examination here.

century, other commentators argued that the "marital partnership" recognized by the community property states is without significance while the marriage lasts, because of the husband's broad managerial powers, and that "the wife's role is essentially that of a back-seat driver who may carp and criticize, but may not take the wheel." The Supreme Court, for its part, has described the husband's authority as an "expansive and sometimes profitable control over the wife's share" terminating only on his death, so that it is only then that she gains "full and exclusive possession, control and enjoyment" of her share of the community property.

The husband's broad power to manage all community property led the Treasury, in its first ruling on the subject, to require him to report all community income. In 1919, however, the Treasury beat a partial retreat from this theory by acknowledging the couple's right to split investment income from community property on separate tax returns, while continuing to require the husband to report all community income generated by the personal services of either spouse. This position was, in turn, abandoned when the Attorney General ruled in 1920 and 1921 that the community property systems of Arizona, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington gave the wife a "vested interest" in one-half of all community income, and that each spouse was therefore taxable on his or her share. As to California, however, the Attorney General ruled that the wife had only "a mere expectancy" under local law, rather than a vested interest.

The exclusion of California from the Attorney General's protaxpayer opinion was upheld in 1926 by the Supreme Court in United States v. Robbins. The Court accepted the government's theory that the wife had no more than "a mere expectancy" in California community property, but also went on to intimate that there was a broader ground for taxing the husband, viz., the fact that "he may spend [community income] substantially as he chooses," even "if he wastes it in debauchery." This language was interpreted by the Treasury as an invitation to reexamine the status of community income in even the most orthodox community property states, and the Attorney General cleared the road for a series of test cases by reconsidering and withdrawing his 1920 and 1921 opinions. While not con-
ceding that these opinions were erroneous, the Attorney General expressed the view that the community property systems in some of these states bore a close resemblance to the California system that had just been held ineffective in the Robbins case, while others differed considerably from it; therefore, he withdrew the earlier opinions, so that the issue could be submitted by the Treasury to the courts.\textsuperscript{46}

Three years later, Poe \textit{v.} Seaborn and three companion cases\textsuperscript{47} reached the Supreme Court, and—17 years after the issue first arose—finally elicited an authoritative judicial resolution of the community property imbroglio. The government summarized its argument for taxing all community income to the husband in these words:

The wife's vested interest in the community property is no more than a right to devise by will or to receive upon the dissolution of the community one-half of the then existing community property with the right in the interim to have the property devoted to such purposes as are in the honest judgment of the husband appropriate for the advancement of community interests. She has no positive powers of control and cannot, to any substantial degree, interfere with the broad powers of control given to her husband.

The husband accordingly is the spouse having the right to control and manage the community property in Washington [the state of residence in Poe \textit{v.} Seaborn] and should be made liable for Federal income tax on the entire community income. This requirement is the more reasonable in view of the fact that under the philosophy of the community property system in that State the community is a legal unit and in view of the further fact that the husband as well as the community is liable on all contracts which he makes for the community.\textsuperscript{48}

Whether by design or accident, none of the four test cases involved community income attributable to the wife's personal services, but the government's theory would have taxed even this type of income to the husband, along with his own earnings and any income from the investment of community property.

The government's argument, however, did not carry the day. After reviewing the legal incidents of community property in Washington, where the taxpayers in Poe \textit{v.} Seaborn were domiciled, the Court held that, despite the husband's managerial control, "the entire property and income of the community can no more be said to be that of the husband, than it could rightly be termed that of the wife."\textsuperscript{49} The Robbins case was distinguished, as based on peculiarities of California law.\textsuperscript{50} Buttressing its conclusion with references to the legislative history of the taxing statutes, the Court con-

\textsuperscript{46. 35 Op. Att'y Gen. 265 (1927). See also 1 T. 2457, VIII-I Cum. Bull. 89 (1929)}
\textsuperscript{47. Goodell v. Koch, 282 U.S. 118 (1930) (Arizona); Hopkins v. Bacon, 282 U.S. 122 (1930) (Texas); Bender v. Pfaff, 282 U.S. 127 (1930) (Louisiana).}
\textsuperscript{48. Brief for Appellee at 8, Poe \textit{v.} Seaborn, 282 U.S. 101 (1930).}
\textsuperscript{49. 282 U.S. at 113.}
\textsuperscript{50. See id. at 116.
cluded that one-half of the community income was taxable to each spouse. On the same day the Court reached the same result for Arizona, Texas, and Louisiana (the states involved in the three other test cases), and the Internal Revenue Service promptly added Idaho, Nevada, and New Mexico to the list of recognized community property states.

Following Poe v. Seaborn, the tax status of a married couple in a community property state differed from that of a married couple in a common law state in two fundamental ways. First, each community property spouse paid the same tax as an unmarried person with one-half the aggregate community income. This result obtained in common law states only in the unusual case of a married couple whose income was earned or received in equal amounts by each spouse. A corollary of this geographical disparity was that marriage usually reduced (and divorce increased) a couple’s income taxes if they resided in a community property state but were neutral tax events for couples in common law states. Second, the federal tax burden for equal-income married couples was identical in community property states, whether the income was attributable to one spouse or to both. In common law states, by contrast, the tax liability of equal-income married couples could vary widely, since it depended on the amount attributable to each spouse.

4. The 1941 defeat of mandatory joint returns.

Its assault in the courts on the tax advantages of community property having been conclusively repulsed in Poe v. Seaborn, the Treasury turned to the legislative arena. Indecisive preliminary skirmishes in 1933, 1934, and 1937 were followed by a full-scale battle in 1941, when the Treasury persuaded the House Committee on Ways and Means to recommend enactment of a provision for mandatory joint returns, designed to eliminate the geographical disparity between the community property and common law states by equalizing the tax on married couples with the same aggregate income.

51. See note 47 supra.
53. In an echo of Poe v. Seaborn, the Supreme Court held in 1971 that a community property spouse was taxable on her half of the community income, even if she was “not really aware of the community tax situation, and not really in a position to ascertain the details of the community income.” United States v. Mitchell, 403 U.S. 190, 205 (1971). The traditional forensic roles of taxpayer and government were reversed in this case, where the taxpayer sought to minimize and the government to magnify the importance of her community property rights. A legislative remedy for the tax-avoider’s innocent spouse was provided by the enactment in 1971 of §§ 6013(e) and 6653(b) (last sentence) to the INT. REV. CODE OF 1954 [hereinafter cited by section]. See also § 981 (citizen married to nonresident alien may “elect out” of foreign community property laws); for background of this election, see J. MERTENS, LAW OF FEDERAL INCOME TAXATION § 19.32a (1942).
54. See Thorson Dissertation, supra note 1, at 57-58.
55. See H.R. REP. No. 1040, supra note 21.

Mandatory joint returns would also have had an important impact within the common law states, where they would have equalized the tax paid by couples with investment income, who were
The most explosive feature of the House Committee's 1941 recommendation was the imposition of the same tax on a married couple's consolidated income as on a single person with the same amount of income. This aspect of the 1941 proposal would have meant an increase in the tax burden for almost all married couples in community property states, as well as for couples in common law states if both spouses had income from personal services or investments. Conversely, two unmarried taxpayers with separate sources of income would have to pay a heavier tax if they got married than if they lived together without benefit of clergy, and many married couples would be able to reduce their tax burden by getting divorced. Quite naturally, therefore, opponents of the proposal assailed it as "a tax on morality."\(^{56}\)

The House Committee on Ways and Means sought to disarm this criticism in advance by solemnly announcing:

It is not believed that the joint return will result in any increase in the divorce rate in the United States or adversely affect the morals of American families. A compulsory joint return in Great Britain has been required since 1914, and their divorce rate is not as high as in the United States.

The rate of divorces by each 1,000 of population in 1935 was, in the United States, 1.71 percent as against 0.10 percent in England and Wales. The number of divorces for each thousand marriages was, in 1935, in the United States, 164 divorces for each 1,000 marriages, in England and Wales, 12 divorces for each 1,000 marriages.\(^{57}\)

able to split their income by intrasposual gifts of income-producing property, with the tax on couples with earned income, who had been barred by Lucas v. Earl from splitting their income for tax purposes. Cf. notes 22-24 supra and accompanying text.

The term "mandatory joint return" is ambiguous; as envisioned in 1941, the plan required husbands and wives to apply to their joint income the same rate schedule that was used by single taxpayers. The sting, therefore, resulted less from the proposed compulsory aggregation of marital income than from the rate schedule, and it could have been increased, reduced, or eliminated by a different rate schedule. The split-income plan enacted in 1948 included a favorable rate schedule for joint returns; joint returns were optional in theory, but the new rate schedule was an offer "that could not be refused" (except in special circumstances, see notes 78-79 infra and accompanying text), and this meant that joint returns became mandatory in fact for almost all married couples. See notes 67-77 infra and accompanying text. The same carrot-and-stick approach is employed by the reform proposed by Pechman; married couples would not be compelled to file joint returns, but an unfavorable rate schedule for married couples filing separate returns would make the filing of such returns costly unless their income was equally divided. See Pechman, supra note 1. Because the usage is so widespread, I have used the term "mandatory joint return" to refer to marital aggregation combined with an unfavorable rate schedule.

56. Any structural provision that increases the taxes paid by two single persons if they get married can be described as a "marriage penalty," unless the same burden will be imposed on them if they cohabit without benefit of clergy. Since the latter measure is not politically likely, constitutional, or enforceable, but see Sweden's example supra note 16, a "marriage penalty" can also be termed "a tax on morality" or "a subsidy to sin." Publicists have not refrained from using these colorful terms. See 1972 House Hearings, supra note 10, at 153 (testimony of Oscar Gray). Opposition to mandatory joint returns that impose a heavier burden on married couples than is borne by two single taxpayers with the same aggregate income is not confined to American taxpayers. British tax law consolidating marital income was vigorously attacked from a socialist perspective in Webb, A Revolution in the Income Tax, in How to Pay for the War 233 (1916), with the same rhetoric: "Legal matrimony would become prohibitive. A substantial premium would even be put on desertion."

Although the Committee did not explicitly say so, there was a more effective way to defuse the "immorality" allegation than these fragmentary statistics (which were not even limited to the taxpaying segments of each country's population)—a separate rate schedule for joint returns under which a married couple would pay twice the tax paid by a single person with one-half the couple's income. But this was a costly way to protect the institution of marriage, since it would have drastically cut the income taxes paid by married couples in common law states. Though accepted in 1948, a tax reduction of this magnitude, given the government's insatiable need for revenue on the eve of World War II, was not in the cards.

But neither, as quickly became apparent, was the mandatory joint return. The political response to the House Committee's proposal was tempestuous:

Of course, the provision was "un-American." The contention was that by making the marital relation a taxable privilege the "sly and tricky" provision was arbitrary and against public policy in that it struck at the institution of marriage, was an attack upon the family, and promoted celibacy. The charge was that it penalized fidelity and awarded perfidy. The argument continued into many other aspects of this same general theme. It was asserted that the provision discouraged marriage by young couples.

The [opponents of mandatory joint returns] became champions of emancipated womanhood. The provision was an encroachment on the independent status and social, economic, and political individuality of women which had been won only after a long, hard struggle. It revived the old common law fiction which made the wife a chattel. Thus it was a step backward and contrary to the trend of American policy, which more and more treated women on an absolute equality with men. A famous phrase in a dissenting opinion of Justice Holmes came into this argument. The provision brought back the horse and buggy days of 1880 when the legal pattern made the husband and wife one "and that one the husband." It was also erroneously alleged that the provision took the money of one person to pay the taxes of another, and that the provision upset the established property laws of the sovereign community property states. In addition, many congressmen argued that the provision was unconstitutional though there was little doubt among fair-minded people that it would be upheld by the Supreme Court.58

Bowing to the storm, the House voted to eliminate the mandatory joint return provision from the bill that became the Revenue Act of 1941. The Senate Finance Committee then recommended a milder remedy, limited to community income, taxing personal service income to the spouse who earned it and investment income to the spouse entitled to manage and

58. R. PAUL, TAXATION IN THE UNITED STATES 275 (1954). The tone of these references to the status of married women has become more than a little jarring with the passage of time. A bit of historical irony in Paul's final sentence is that he himself had expressed doubts about the constitutionality of mandatory joint returns only 5 years earlier. See Paul & Havens, supra note 21, at 266-71.
control it under local law.\textsuperscript{59} This proposal, in turn, was rejected by the Senate.

5. The spread of community property.

The income tax advantages of community property having come unscathed through these judicial and legislative battles,\textsuperscript{60} there was a stampede at the state level to share in its benefits. Oklahoma—true to its sobriquet, the "Sooner State"—had already started in 1939 by authorizing its married citizens to elect to be governed by a newly enacted community property system, and Oregon followed its lead by enacting a similar statute in 1943. In 1944, however, the Supreme Court decided in \textit{Commissioner v. Harmon}\textsuperscript{61} that the Oklahoma and Oregon do-it-yourself laws were substantially the same as the income-splitting contract between husband and wife that was held to be ineffective for federal tax purposes in \textit{Lucas v. Earl}. The Court went on to announce that only a non-elective system of community property, "made an incident of marriage by the inveterate policy of the State," could qualify for income splitting under \textit{Poe v. Seaborn}.\textsuperscript{62} As the dissenting Justices (Douglas and Black) cogently argued, however, community property is an optional arrangement even in the original community property states, since it is dependent on the marital decision to live in a community property state and to refrain from exercising the option, available in most community property states, to hold all acquisitions during marriage as separate rather than community property.\textsuperscript{63} Thus, the result of the \textit{Harmon} case was that the community property system was effective for federal income tax purposes if under local law the couple could "opt out" of it, but not if they had to "opt in."

While it was easy for the scholar to ridicule \textit{Harmon}'s distinction between a condition precedent and a condition subsequent, it was almost as easy for the legislator to sidestep its result with a new statute. Oklahoma and Oregon promptly replaced their optional community property systems with

\begin{footnotesize}
\begin{enumerate}
\item[60.] The estate tax advantages of community property, however, were drastically cut back by the Revenue Act of 1942, which required community property to be included in its entirety in the estate of the first spouse to die, unless attributable to the surviving spouse’s personal services or separate property and in any event taxed the first estate on the one-half subject to that spouse’s testamentary control. See Revenue Act of 1942 ch. 619, § 402, 56 Stat. 941, amending Int. Rev. Code of 1939, ch. 2, § 811(e) 53 Stat. 122. The Supreme Court held the amendments constitutional in \textit{Fernandez v. Wiener}, 326 U.S. 340 (1945). Similar changes were made in the gift tax. See Revenue Act of 1942, ch. 619, § 453, 56 Stat. 953. These rules might have become the prototype of changes in the income tax area, but they were repealed in 1948, when Congress authorized income splitting for all married couples and concurrently enacted the estate and gift tax marital deductions. See S. Rep. No. 1013, 80th Cong., 2d Sess. 26–29, reprinted in 1948–1 Cum. Bull. 285, 303–06. See also note 73 infra and accompanying text.
\item[61.] 323 U.S. 44 (1944).
\item[62.] Id. at 46.
\item[63.] Id. at 53–56. See Shoenhair v. Commissioner, 45 B.T.A. 576 (1941), and cases there cited.
\end{enumerate}
\end{footnotesize}
mandatory ones, but neither tempted fate by going on to permit their married citizens to elect out of the new law, despite the fact that the ostensibly mandatory systems of some original community property states contained this escape hatch. Their new statutes were later accepted as effective by the Internal Revenue Service. Hawaii, Nebraska, Michigan, and Pennsylvania soon joined the community property parade, and by 1948 a similar step was under discussion in states as far removed from the civilizing mission of Spanish law as Massachusetts and New York. An influential New York study warned that adoption of a community property system was fraught with difficulties and urged that every effort be made to get a federal solution, but it also recommended state self-help if Congress did not act promptly.

C. 1948: The Optional Joint Return

The community property epidemic—which some enthusiasts praised as a married women's liberation movement—forced Congress to confront, once again, the problem of geographical disparity in the tax burdens borne by married couples. But the range of legislative choice, viewed realistically, was quite narrow. A revival of the remedy proposed by the House Ways and Means Committee in 1941—a mandatory joint return, with the couple's consolidated income taxed at the rate applicable to single persons—would have invited a renewal of the old attack ("a tax on morality"). Moreover, those who succeeded in defeating the proposal in 1941 would now have the "new" community property states as allies in the legislative battle. The 1941 Senate Finance Committee's proposal to tax community income to the person who earned it was no more appealing; it too would invite opposition from both old and new community property states, and it had the additional defect of focusing on personal service income, while leaving married couples free to split their investment income by intraspousal gifts. A third possibility for Congress was to do nothing, a strategy that would probably have been followed by universal adoption of the community property system at the state level, regardless of any local misgivings about its nontax merits.

Instead of standing pat, Congress decided in 1948 to authorize all married couples to aggregate their income and deductions on a joint return and to pay a tax equal to twice what a single person would pay on one-half

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67. See note 56 supra and accompanying text.
68. See note 59 supra and accompanying text.
their consolidated taxable income. In its impact on the federal revenue, this device was virtually the same as standing idly by while the whole country adopted the community property system, but enactment of the income-splitting joint return meant that the political credit for reducing taxes was concentrated on Congress rather than dispersed among the state legislatures.

Though the economic case for a massive tax reduction was not overwhelmingly persuasive, the idea had great political support in 1948, and for many the income-splitting joint return was an attractive device to effectuate a reduction. Unlike an across-the-board cut in tax rates, the joint return could be supported as a way of terminating both the historic disparity between community property and common law states and the special opportunities for intraspousal income splitting that were available to married couples with income-producing property. The Senate Finance Committee offered this summary of the merits of the income-splitting joint return:

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. In effect, these amendments represent the adoption of a new national system for ascertaining Federal income tax liability. The adoption of these amendments will extend substantial benefits to residents of both community-property and common-law States.

Placing the legislative decision in a broader context, Surrey added this endorsement:

If tax reduction of [great] magnitude was to be afforded [to middle and upper bracket taxpayers], it was wise tax policy to use the dollars of tax reduction to accomplish needed reform and build an improved tax structure. The best chance for a more equitable and economically effective tax system lies in the intelligent allocation of any tax reduction. The adoption of a presently acceptable solution to the family income problem represents the one bright spot in the Revenue Act of 1948.
As anticipated, once the privilege of income splitting was extended to married couples in common law states, the "new" community property states lost their taste for Spanish law and repealed their statutes. The joint return became virtually universal for married couples, except for those too hostile to cooperate in signing the return and for a few unusual situations in which separate returns had minor residual advantages.

At the time, the Revenue Act of 1948 seemed to have added a chapter "[t]o the long history of the treatment of family income [that] is likely to be the last for many years." In fact, new chapters were added by Congress in 1951, 1954, and 1969. Moreover, the basic 1948 decision to equalize the tax burden on married couples with equal aggregate income has itself come under attack recently, though it was once widely thought to be settled "for all time."

D. Residual Separate Tax Treatment of Spouses After 1948

Although the allocation of most tax items as between husband and wife became a matter of indifference with the consolidation of marital income and deductions on the 1948 joint return, the statutory reform left intact many "individualistic" elements of the tax law. Not only has the income of children been insulated from aggregation, but many tax provisions continue to treat husband and wife as separate individuals even if they file a joint return. Particularly noteworthy are a number of provisions with dollar amount limitations. The $100 dividend exclusion of section 116, for example, is granted on a per-taxpayer basis. Since the exclusion is granted only to taxpayers who receive dividends, the maximum allowance of $200 on

72. See Note, note 65 supra, at 337-47.
73. If income is divided about equally and one spouse incurs substantial medical expenses, separate returns may increase the medical expense deduction by reducing the 3% floor of § 213(a)(1). See also § 152(e)(2), which may make separate returns preferable for some low-income taxpayers because one (or even both) can then qualify as a dependent of a third person. Until the enactment of § 1211(a)(2) in 1969, separate returns could be advantageous if both spouses had capital losses, since $2,000 of ordinary income could then be offset by their capital losses, while only $1,000 could be offset on a joint return.
74. See notes 92-107 infra and accompanying text.
75. See notes 82-90 infra and accompanying text.
76. See also § 152(e)(2), which may make separate returns preferable for some low-income taxpayers because one (or even both) can then qualify as a dependent of a third person. Until the enactment of § 1211(a)(2) in 1969, separate returns could be advantageous if both spouses had capital losses, since $2,000 of ordinary income could then be offset by their capital losses, while only $1,000 could be offset on a joint return.
77. See notes 92-107 infra and accompanying text.
78. Indeed, Congress deliberately eschewed the aggregation of children's income with their parents' even where consolidation would have been most appropriate and would almost certainly have encountered no constitutional barrier, viz., the earnings of minor children in states vesting control over such income in the parents, perhaps because aggregation was deemed politically unacceptable. For example, a storm of protest ensued when New York sought, after 40 years of neglect, to enforce a statute requiring parents to report their minor children's income from babysitting and similar activities, which quickly led to a change in the law by a unanimous vote in the state legislature. See Groves, supra note 3, at 112. Instead, in 1954 Congress explicitly renounced consolidation by enacting § 73 which taxes the child on such income rather than the parent. This rule achieved national uniformity in the face of divergent state laws concerning a parent's entitlement to his child's income, but the opposite rule—compulsory consolidation—would also have brought about uniformity.
a joint return is automatically available for dividends that constitute community income, but in common law states it can be obtained only if each spouse owns stock producing at least $100 of dividends or if their stock is owned jointly. Thus, the treatment of married couples under section 116 varies with the legal division of ownership between the spouses. The reverse is true of the additional first-year depreciation allowance of section 179, whose limits are $10,000 per year for single persons and $20,000 for married couples filing a joint return, regardless of how ownership of the property is divided between them. The larger allowance granted to married couples by section 179 means that marriage can be advantageous and divorce disadvantageous, but all married couples are treated alike by section 179, since legal ownership of the depreciable assets is not controlling. The $50,000 limit on the special tax rate on long-term capital gains, imposed by section 1201(b), functions in a more complex manner. Since the limit is identical in amount for single persons and married couples, two individuals who consistently realize more than $25,000 each of long-term capital gains will be worse off if they get married and better off if they get divorced. But if one consistently realizes capital gains in years when the other realizes losses (e.g., $100,000 of gains for one and $50,000 of losses for the other), the right to offset gains and losses on a joint return will improve their position, while divorce will worsen it. Since the $50,000 limit is the same for all taxpayers, however, the treatment of married couples does not depend on the division of legal ownership between them. 70

Similar problems arise when a tax allowance is conditioned on the number of taxpayers involved in a particular activity. For example, a corporation may not make a Subchapter S election if it has more than 10 shareholders. Since stock held by husband and wife in joint ownership or as community property is treated by section 1371(c) as owned by one shareholder, a corporation with 11 shareholders may become eligible to file a Subchapter S election if two of its shareholders get married and put all their stock into a joint tenancy, but lose its eligibility if the stock is divided between them on divorce. 80 If a married couple prefers to hold their stock in separate accounts, however, they may thereby bar a Subchapter S election. To this extent, Subchapter S discriminates among married couples according to the form of legal ownership they employ for their assets.

The personal holding company provisions, on the other hand, contain constructive ownership rules that cause husband and wife to be treated as a single shareholder, regardless of how they hold their assets. 81 As a
result, a corporation with enough shareholders to escape the personal holding company tax may become vulnerable if two shareholders get married and regain its immunity if they are divorced. A similar fate can befall two corporations each of which enjoys its own $25,000 corporate surtax exemption and $100,000 accumulated earnings credit. If a shareholder of one marries a shareholder of the other, the two corporations may become "affiliated" under sections 1561-1564, requiring them to share a single exemption and credit, and divorce may terminate the corporate affiliation and restore the status quo ante. In many situations, these consequences of marriage and divorce are visited upon other shareholders, even if they are complete strangers to the couple whose marital status is controlling.

To the extent they recognize legal ownership between spouses as a tax factor, provisions of this type are inconsistent with the fundamental decision in 1948 to impose the same tax burden on all equal-income married couples, regardless of the source or form of income. But Congress has not been much concerned with tidying up the conceptual loose ends left by the 1948 revolution. Instead, legislative attention has been focused on the forgotten people of 1948: the nation's single persons.

II. Relative Tax Burdens of Married Couples and Other Taxpayers

A. The Problem Emerges

The congressional committee reports recommending enactment of the 1948 joint return argued at length that all equal-income married couples should pay the same amount of income taxes, but said nothing about the relationship of that burden to the tax burden on other taxpayers.\(^{82}\) It is easy to account for this silence. An unspoken premise of the 1948 legislative debate was that married couples in the community property states were not to be subjected to a tax increase; the bruising political fight of 1941, ending in the defeat of two proposals that would have produced such an increase, was still fresh in mind. Given this constraint, Congress was led almost irresistibly to extend the tax advantages of the community property system to married taxpayers in other states. If these taxpayers were to be equalized with community property couples, and the latter were not to be stripped of their historic privilege of paying the same tax as two unmarried taxpayers

mitting husband and wife to elect to be treated as a unit in applying § 1034, so that gain realized on the sale of a personal residence will not be recognized if a replacement residence is purchased within a specified period of time, even though the first residence was owned by the husband and the second was purchased by the wife, or vice versa. If the election is not made, however, the gain will qualify for nonrecognition only if the same spouse owns both houses, or both are held in joint ownership.

TAXATION AND THE FAMILY

each with one-half their combined income, the relationship between the tax liability of married couples and that of unmarried taxpayers was predetermined; no discussion seemed necessary.

Once enacted, however, income splitting for married couples came to be seen as a tax allowance for family responsibilities. So viewed, it was assailed as unfair by taxpayers with similar family responsibilities, such as unmarried persons with dependent children or parents, who argued that their taxpaying capacity was no greater than that of a married couple with the same amount of income. To be sure, anyone supporting a dependent was entitled to an exemption, but this allowance ($600 per dependent, under 1948 law) was far less generous than the special rate schedule applicable to married couples filing joint returns.

Acknowledging merit in this complaint, in 1951 Congress prescribed a special head of household (“HOH”) rate schedule for an unmarried person maintaining his home as the principal place of abode for a dependent or for a child (or other descendent) even if not a dependent. The new schedule for HOH returns produced a tax liability for a given amount that was midway between the liability of a single person and that of a married couple filing a joint return.

Thus, the rate concession to heads of households was only half a loaf, when compared with the tax advantage of the joint return. But the Code does not require HOH taxpayers to amalgamate their income with the income of their fellow householders, and this sometimes enables a two-person household to pay less than a married couple with the same aggregate income. But if the head of household is the only breadwinner, the HOH tax liability is heavier than the tax on a married couple, even if their income and family expenses are identical.

The 1951 reform was reexamined by Congress only 3 years after its enactment. In 1954, the House proposed to extend the full benefit of income splitting to any “head of family,” a new concept that was broader in some respects and narrower in others than the term “head of household” as defined by the 1951 legislation. The reasons for the proposal, as explained by the House Committee on Ways and Means, were:

83. This problem had been anticipated by the 1947 Treasury study describing the split-income proposal for married couples: “The split-income plan would produce differences in tax burden between the married couple and the head of family... In view of these differences it may be necessary to consider in conjunction with a split-income plan the case for granting certain heads of families the tax equivalent of equal division of income in order to place them on a comparable basis with married couples.” Treasury Department, supra note 1, at 858.

84. Int. Rev. Code of 1939, § 12(c) (now Int. Rev. Code of 1954, § 1(b)).

85. Under the 1974 rate schedules, for example, a married couple with $24,000 of taxable income pays $5,660 in taxes, while a head of household with the same income pays $6,220. But if the latter’s income is divided between the head of household ($16,000) and a child ($8,000), their tax liability would be $3,540 (HOH) plus $1,590 (child), or a total of $5,130.

86. Cf. note 147 infra.
Your committee believes that the present provision is unfair in that it denies full income splitting to widows and widowers with small children who prior to the death of their spouses had this tax advantage. Moreover, the fact that a dependent may not be able, or willing, to live in the home of the taxpayer may increase, rather than decrease the expenses of the taxpayer. On the other hand, the present provision grants head of household status on account of children or grandchildren whom the taxpayer does not actually support.

Under this bill a "head of family" is entitled to full income-splitting benefits. This not only removes the hardship described above but also makes it possible to do away with the separate rate schedule required by present law for heads of households. Also, under the bill the dependent giving the taxpayer head of family status no longer must live in his household. On the other hand, the taxpayer will have to actually support the dependent giving him "head of family" status, and the classes of dependents which may make the taxpayer eligible for this status are limited to his son, daughter, father, mother, brother, or sister.87

The Senate Finance Committee recommended a rejection of the House proposal, because it "did not treat all income groups equally and benefits primarily the middle- and upper-income groups."88 When the bill went to conference, the dispute between the House and the Senate was compromised by expanding the existing HOH provisions to embrace a dependent parent, even if that parent were living separately from the taxpayer, and by according the full benefits of income splitting to a "surviving spouse" (defined as a widow or widower whose home is the principal place of abode for a dependent child) for two taxable years after the spouse's death.89

The HOH and surviving spouse provisions of 1951 and 1954 responded to the complaint of unmarried taxpayers with dependents that their family responsibilities were comparable to those of married couples. But the provisions did not question—indeed, they implicitly ratified—the tax differential established in 1948 between a married couple and a single person with the same income. By 1969, when Congress made a major change that will be described shortly, the 1948 principle of imposing the same tax on a married couple as on two single persons each of whom has one-half the couple's income had come to produce the illustrative differences set out in Table 3. Increasingly, these disparities became the subject of public attention.

89. See Pechman, Individual Income Tax Provisions of the 1954 Code, 8 Nat'l Tax J. 114, 128 (1955). There are a lot of fine, even finicky, distinctions in the head-of-household and surviving spouse provisions, and judicial interpretations of such terms as "maintains," "household," and "principal place of abode" have added more refinements. Given the diversity of family responsibilities and living arrangements that characterize our society, any legal boundary in this area will inevitably separate cases whose differences are barely perceptible.
TABLE 3

TAX LIABILITY OF SINGLE AND MARRIED TAXPAYERS (1970 RATES)

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Single Person</th>
<th>Married Couple (Joint Return)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10,000</td>
<td>$2,190</td>
<td>$1,820</td>
</tr>
<tr>
<td>20,000</td>
<td>6,070</td>
<td>4,380</td>
</tr>
<tr>
<td>50,000</td>
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</tr>
<tr>
<td>100,000</td>
<td>55,490</td>
<td>45,180</td>
</tr>
</tbody>
</table>

Note: Being based on taxable income, the table does not reflect the effect of deductions and personal exemptions, which may vary among the taxpayers being compared.

B. The Insoluble Dilemmas

Some tax theorists have been unable to locate a justification for these differentials. They see income splitting of the 1948 variety as a “subsidy” for getting married and, since the benefits rise with the couple’s income, as an “erosion” of the progressive rate structure—even as a “loophole.”

These pejorative labels imply that the separate rate schedule for married couples is an unjustified departure from a generally accepted standard. What, then, is the “proper” relationship between the tax rates on joint and individual income?

In offering answers to this question, tax theorists have customarily pointed to the following differences between the economic status of single persons without family responsibilities and married couples with the same amount of income, but without agreeing on the weight or even on the relevance of all of these characteristics:

1. The income of a married couple must support two persons, not one.
2. As compared with two single persons, a married couple benefits from economies of scale—a single kitchen will suffice, for example, and their food can be purchased in larger quantities.

90. Table 3 is based on Richards, Single Versus Married Income Tax Returns under the Tax Reform Act of 1969, Taxes 301, 302 (1970).
92. See, e.g., P. Stern, The Rape of the Taxpayer, 120 (1973): “In most American homes, if there is only one breadwinner, it is the husband. The weekly pay check is made out in his name. Nevertheless, the tax laws permit the husband, in making out his tax return, to make believe that half of the pay check has been earned by his spouse. This fiction comes to pass because of special tax rates that may be used by couples filing a joint return. This is an enormously expensive fiction: even most experts are astonished at its prodigious cost, but according to the Brookings Institution computer analysis, this one feature of the tax law costs the U.S. Treasury about twenty-one and a half billion dollars every year!” (emphasis in the original).
If only one spouse is employed, the married couple enjoys the untaxed housework performed by the other spouse.

This summary of differences compares single persons who live alone and have no dependents with one-job married couples. As will be seen, there is ample room for disagreement about the relative tax burdens that should be borne by these two polar cases. But, alas, these are neither the only, nor necessarily the most significant, actual living patterns of American taxpayers. Attention must also be given to single persons who support children or other dependents, whether in their own homes or elsewhere, unmarried persons who share the expenses of a single household, two-job married couples, and taxpayers with still other arrangements." Unfortunately, when the debate is enriched by these complexities, the already divergent pathways to reform dissolve into a skein of competing trails.

1. The burden on marital income.

Marriage affects the legal rights of each spouse to what would otherwise be “his” or “her” unfettered income by creating an obligation of support and restrictions on the right to transfer property during life and at death. Since the receipt of $10,000 of marital income does not carry with it the same rights that are embodied in $10,000 of “single” income, these two amounts should not necessarily be taxed as though they were identical. Instead, it is often argued, marital income should be attributed, and taxed, one-half to each spouse. The rationale is not only that the legal incidents of marital income are divided between the two spouses, but also that they both contribute to its realization. Community property law has been subjected to much derision, but in recent years at least, most of its critics have embraced its basic principle of a “marital partnership” and have complained only that it fails to practice what it preaches. Even in com-

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93. For a chart describing some of these other family and household patterns, see Table 6 infra.
94. I do not mean to suggest that the law of support is satisfactory today, or that the legal obligations imposed in theory are readily enforced. See B. Barcock, A. Freedman, E. Norton & S. Ross, Sex Discrimination and the Law 619-31 (1975); Krauskopf & Thomas, Partnership Marriage: The Solution to an Ineffective and Inequitable Law of Support, 35 Ohio St. L.J. 558 (1974). Support laws are criticized, however, for failing adequately to assure the wife’s claim to a share of the husband’s income. In framing a tax structure, it is appropriate to build on this claim, rather than to denigrate it by suggesting that a spouse’s legal and moral rights to his or her earnings are identical to those of an unmarried person.
95. See, e.g., notes 40 & 58 supra and accompanying text.
mon law states, the concept of a marital partnership is a widespread ideal and, whether realized in fact or not, it is an appealing principle to use in fixing the tax liability of married couples.

A diametrically opposing school of thought points out that the legal, emotional, and social burdens on marital income are self-imposed, since they result from the voluntary decision of the parties to get married. These tax theorists argue that a tax on income should take no more account of a marriage vow than of the taxpayer’s propensity to spend his or her income on vacations, hobbies, or riotous living.97 In their view, the fact that a married person has less legal, emotional, or social control over “his” or “her” income than a single person is irrelevant. The loss of control to the other spouse, it is asserted, merely reflects a personal decision to spend one’s income in a particular manner, in anticipation of greater satisfactions than alternative uses of the funds.98

The marriage-as-consumption objection to taxing marital income differently from an equal amount of “single” income is sometimes buttressed by an appeal to the Haig-Simons definition of income.99 The force of this appeal to authority is weakened, however, by the fact that Simons himself wobbled when he discussed the issue—perhaps in implicit acknowledgement that the definition seeks to determine whether a given item constitutes income, but does not purport to decide who should be taxed on the item in question if there are several candidates for this privilege. Moreover, in an area so entangled with social and psychological issues of a “non-tax” character, it is absurd to think that an economist’s definition can provide a uniquely “correct” solution. Lexicographers reflect public policy more often than they make it.

In any event, though voluntary, marriage has social consequences that are far more fundamental than ordinary consumption expenditures. This conclusion does not necessarily lead irresistibly to 1948-style income splitting, or indeed to any other tax allowance for married persons. What it does suggest is that, there being a significant difference between the income of a married person and the same amount of income accruing to a single person, a distinction between marital and single income does not breach any

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97. A similar objection is sometimes offered to tax allowances for children and other dependents. See notes 147–79 infra and accompanying text.
98. See, e.g., Pechman, supra, at 479, (referring to “people who prefer to spend part of their income on a wife rather than to spend it in other ways.”). I do not know of many marriage-as-consumption theorists, however, who are prepared to apply the theory rigorously and to oppose all tax allowances for marriage. Pechman, for example, favors the use of personal exemptions rather than the rate schedule to adjust tax burdens to family size.
99. “Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question.” H. Simon, PERSONAL INCOME TAXATION 50 (1938). See generally A COMPREHENSIVE INCOME TAX BASE? (1968).
rational principle of "neutrality." This in turn means that more heat than light is generated by applying such labels as "subsidy," "tax erosion," and "loophole" to legislative decisions taxing marital income differently from "single" income.

Of course, the burdens on one's income that stem from marriage are not unique. Parents have a legal obligation to support their minor children, and children must support their parents under certain conditions. There are also powerful social, psychological, and religious pressures to support one's legal dependents on a more generous scale than the law requires and to extend aid to other relatives who are outside the circle of legal compulsion. I have suggested elsewhere that what we choose to call the husband's income is not solely "his" to the extent that he is required by law to use it for the support of his wife or children and that he could properly be regarded as a conduit pro tanto, this portion of his earnings being excluded from his return and taxed to the wife or child. Since law is only one measure of the extent to which income is shared, it would not be fanciful to apply the "conduit" theory beyond the level of legally enforceable support by permitting income splitting on a fractional basis between the wage earner and the members of his or her family. On the other hand, the legal and social relationships between taxpayers and their children, parents, and distant relatives might properly be distinguished by Congress from the obligations of one spouse to another. Responsibility for the use of the family income is ordinarily more equally divided between marital partners than between them and other members of the nuclear or extended family, and this difference can justify (though of course it does not compel) a fuller tax recognition of marital obligations than other instances of family support.

2. Economies of scale.

As compared with a single person having no dependents, a married couple with the same amount of income must feed, clothe, and house two persons rather than one. As compared, on the other hand, with two unmarried persons who live separately, a married couple enjoys economies of scale in consumption. A single place of abode is cheaper than two separate establishments, and the duplication of many other expenses, from automobiles to newspaper subscriptions, can often be avoided. Reductions

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See B. Bittker, A "Comprehensive Tax Base" as a Goal of Income Tax Reform, 80 Harv. L. Rev. 925 (1967), in A Comprehensive Income Tax Base?, supra note 99, at 1, 51. The same approach is developed in detail by Professor Wayne Barnett, who points out that allocating income in this fashion is especially appropriate if the focus of tax policy is, as he argues it should be, on the consumption rather than the source of income. See W. Barnett, [untitled], 1975 (unpublished manuscript on file with Prof. W. Barnett at Stanford Law School). See also supra note 1, at 848, 862-63 (discussing a per capita division of family income); note 168 infra.
in the cost of still other items, such as food, are also typical, even though
the expense may not be cut in half.

These observations often lead to the conclusion that a married couple
with, say, $20,000 of income should pay less tax than a single person with
$20,000 of income, but more than two single persons with $10,000 of in-
come each. This conclusion is closely linked with the rationale, discussed
above, for taxing marital income more leniently than the same amount of
"single" income, since the married couple's economies of scale can be
treated as an offset to the fact that their income must support two persons
rather than one. But the same type of calculation might be employed in
fixing the tax liability of certain other taxpayers. In the case of a widow
with a dependent child or a taxpayer with a dependent parent, for ex-
ample, a single income has to provide for two persons, but the cost of
supporting the dependent is less if they live in one household rather than
two. The phenomenon is not confined to two-person groups; it is often
suggested or assumed that tax allowances for married couples or other
persons with two or more dependents should take account of the extra
mouths that must be fed, discounted to reflect the economies of scale avail-
able because the group actually, or presumptively, occupies only one place
of abode.

It is far from clear, however, that economies of scale should be taken
into account. For one thing, no tax law could consistently do so. Unmar-
ried persons often share the expenses of a single household and members
of a commune who buy their soy beans by the bushel save even more
money, but it would be intolerably abrasive to gear their tax liability to
their living arrangements, taxing unrelated persons who live together
more heavily than those who prefer solitude.

The practical barrier to taking the economies of scale enjoyed by these
unmarried groups into account, however, does not necessarily mean that
comparable savings should be ignored in the case of married couples and
other family groups. Unrelated persons who share expenses do not get any
tax allowance; by contrast, if the taxpaying capacity of married couples
is to be fixed by reference to their cost of living, the relevant standard is
the average cost of maintaining a single household, rather than two sepa-
rate establishments. But it is also arguable that marital income should be
taxed as though realized one-half by each spouse, with each paying the
same tax as a single person with that amount of income. This was the prac-
tical outcome of the joint return from 1948 to 1971; the married couple's
economies of scale were disregarded, but so were any economies of scale
that might have been enjoyed by the two single persons to whom they were
analogized.
Assuming, however, that the married couple's economies of scale (as compared with a single person who lives alone on the same income) affect their taxpaying capacity and should be taken into account in fixing their tax liability, how should the amount of their cost of living advantage be ascertained?

In answering this question, tax theorists usually turn for guidance to government cost-of-living indexes for households of various sizes. If these estimates demonstrate that a one-person household can maintain the same standard of living as a two-person household for 75 percent of the latter's cost, for example, it is customarily argued that the taxpaying capacities of the two units bear the same relationship and that their tax liabilities should be fixed accordingly. On these assumptions, a single person with $3,000 of income should pay the same tax as a married couple with $4,000 of income, a single person with $6,000 of income should pay the same tax as a married couple with $8,000 of income, and so on.

The weakest part of this theory is concealed in the phrase "and so on." The theory may be persuasive (or, at least, the best we have) for taxpayers at low income levels, but its application to taxpayers further up the income ladder depends on the continued validity of the cost-of-living indexes. But the fact that a single taxpayer could survive on $3,000 a year while a married couple would need $4,000 for a similar survival kit is a flimsy reed for concluding that a single taxpayer with $75,000 of income can live as well, and hence has about the same taxpaying capacity, as a married couple with $100,000 of income.

The cost of living indexes with which we are familiar, however, focus almost exclusively on taxpayers at lower or very modest income levels. But the search for a rich man's cost-of-living index as a guide to the relative taxpaying capacity of high-income households of various sizes encounters hopeless ambiguities. If this were only a matter of a different "market basket"—squab, artichokes, and scotch rather than hamburger, potatoes, and beer—the Labor Department could recompute its estimates with tolerable accuracy. The real problem is that the very concept of a comparable "cost of living" evaporates when the analyst turns from near-subsistence taxpayers to wealthy ones.


102. For a systematic application of these welfare-ratios to taxpayers at different income levels, see Bridges, Family Need Differences and Family Tax Burden Estimates, 24 NAT'L TAX J. 423 (1971).

103. The Labor Department describes its budget as being "adequate" for family living. See, e.g., BUREAU OF LABOR STATISTICS, note 101 supra at iii. Some efforts have been made to project a cost-of-living index for families having a "higher budget" ($18,000 for a family of four). See, e.g., Brackett, note 101 supra.
If well-to-do married couples entertain more lavishly than their unmarried friends of equal means, should the differential be taken into account in fixing their respective tax liabilities? If rich unmarried taxpayers are more likely to buy their meals in expensive restaurants than to dine at home, or if they frequent night clubs while their married friends are content with a TV set, should this be counted as a burden, or as an advantage, of their single status? If married couples feel the need to save part of their income to protect the survivor if the breadwinner dies first, and unmarried taxpayers are less concerned about the future, is the cost of living pro tanto greater for married couples?\textsuperscript{104}

These uncertainties in the very meaning of the term "cost of living" strike me as so fundamental as to make it impossible to establish comparable personal budgets for unmarried and married high-income taxpayers, in order to compute family-size ratios similar to those computed for low-income taxpayers. But even if the obstacles are circumvented and it turns out, for example, that an unmarried taxpayer with $60,000 of income can live on the same scale—theater tickets, European vacation, Manhattan apartment, ski lodge, custom-tailored clothing, etc.—as a married couple with $100,000, would this suggest that their tax liabilities should be the same? Perhaps both taxpaying units would incur the same sacrifice if their consumption were reduced, but this is not self-evident, and we have no better guide than intuition in making this judgment. Once this is recognized, a more basic doubt arises. Perhaps the initial hypothesis that the tax liabilities of households of different sizes should be related to their respective costs of living is valid only for taxpayers at or near the subsistence level and breaks down when the major items in the "cost of living" are luxuries.\textsuperscript{105}

3. The value of unpaid household services.

In comparing the taxpaying capacities of married couples and single persons, tax theorists often point out that marriage usually brings about a

\textsuperscript{104} The Treasury Study refers to the fact that "the proportion of income used for consumption purposes tends to decrease and savings tend to increase as income increases" and assumes that a felt need to accumulate savings, even for the retirement or the support of children, is not part of the cost of living. See Treasury Department, supra note 1, at 846. But a contrary view is at least equally reasonable, though it would be difficult if not impossible to measure the amount of savings that taxpayers at any given income level customarily regard as part of their cost of living.

\textsuperscript{105} To be sure, cost-of-living indexes always embody prevailing social and cultural assumptions; if exported to the Indian subcontinent, the Social Security Administration's "poverty line" would be a measure of comparative affluence. But confined to the United States, it designates a category of persons who, by general agreement, have little or no "taxpaying capacity." This suggests that it is also a useful measure of the comparative taxpaying capacities of persons who are only slightly above this bottom category. Groves describes a Swedish system that provides substantially the same differentiation between married couples and single persons at low income levels as the 1948-71 United States system but reduces and ultimately eliminates the differential as income rises. See H. Groves, supra note 1, at 104.
change in the ratio of money to non-money income, the latter consisting of the material benefits that flow from do-it-yourself work at home. If only one spouse is employed outside the home, these benefits—not taxable under current law—can obviously be of great economic value, but even if both spouses are employed, they may derive more untaxed income from household activity because they can cooperate—one can hold the ladder while the other is painting the ceiling, etc.—than two unattached individuals who live alone.

Since there is no likelihood that Congress will change the law by requiring unpaid household services to be valued and included in taxable income, any attempt to relate the tax rate on a married couple's money income to the value of unpaid services is bound to generate inequalities. If their tax, as compared with the liability of a single person, is based on the assumption that one spouse typically stays at home and augments their money income by performing household services, the tax bill of two-job couples will be unjustifiably high. If separate rate schedules are prescribed for one-job and two-job couples, the result will be an indirect tax on the non-money income of one-job married couples, without a corresponding tax on the non-money income of single persons who are able to perform substantial domestic services because they live on income from investments.

Assertions that the tax advantage of income splitting under current law is a "loophole" seem based, at least in part, on a concept of taxpaying capacity that takes into account the imputed income of one-job married couples but not the imputed income of other persons. Perhaps income splitting fails to eliminate the advantage derived by this large and important group of taxpayers from the fact that the value of household services is not taxed. (I say "perhaps" because there is no theoretically "correct" tax rate on married couples and hence there is no way to prove that the value of the stay-at-home spouse's household services is—or is not—already reflected by the tax rates applicable to married couples.) If there is a culprit, however, it is not income splitting, but the failure to tax imputed income.

4. Closing the "gap."

In the end, therefore, the tax rate differential between single and married persons rests—and must rest—on judgments as subjective and politi-

107. But the distinction might be supported on the theory that the imputed income of married couples is taken into account only to measure more accurately the additional cost of supporting the second person in the household. This rationale would imply that imputed income should also be taken into account in fixing the level of dependency deductions and other tax allowances for family size. See note 157 infra.
TABLE 4
ADJUSTED GROSS INCOME REPORTED ON 1971 TAXABLE RETURNS
(Dollar Amounts in Billions)

<table>
<thead>
<tr>
<th></th>
<th>All Returns</th>
<th>Joint Returns*</th>
<th>Separate Husband and Wife Returns</th>
<th>Head of Household Returns</th>
<th>Single Returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>All returns</td>
<td>$674.4</td>
<td>$525</td>
<td>$10</td>
<td>$24</td>
<td>$111</td>
</tr>
<tr>
<td>AGI of $10,000 to $25,000</td>
<td>341</td>
<td>307</td>
<td>3</td>
<td>6</td>
<td>25</td>
</tr>
<tr>
<td>AGI of $25,000 and over</td>
<td>110</td>
<td>102</td>
<td>0.6</td>
<td>1.4</td>
<td>6</td>
</tr>
</tbody>
</table>

* Includes surviving spouse returns.
Source: U.S. DEP'T OF TREASUry, STATIsTics OF INcoMM—1971 INDIVIDuAL INcoMM TAx RETuMRs 8–10, 13, 15, Tables 1–2 (1972).

cal as those that determine the degree of progression in the rate schedule itself. Moreover, even if general agreement were reached that the differential between tax rates on individual and joint income is too large at present, the best remedy would not necessarily be—as is sometimes assumed—a rise in the liability of married couples. After all, a gap may be narrowed from either end.

Repealing income splitting would, of course, greatly increase both the income tax’s yield and its rate of progression. But this fact does not imply that income splitting is a loophole. If increases in yield and progression are thought desirable, they can and should be promoted on their merits. Such changes can be accomplished through suitably graduated rate increases on both individuals and married couples; there is no need to eliminate whatever rate differential between these groups is thought to be appropriate. Conversely, the differential itself can be narrowed or widened without significantly changing the tax’s aggregate yield or rate of progression.

In deciding how to close the tax gap between married and single taxpayers, should that seem desirable, one should note that joint returns now report the overwhelming bulk of all income subject to tax. In 1971, for example, the $674 billion of adjusted gross income reported on taxable returns was divided as shown in Table 4.

Converted into percentages, these statistics disclose that about 78 percent of all adjusted gross income is reported by married couples on joint returns, while only about 16 percent is reported by single persons who are not heads of households. Even more significant are the percentages for taxpayers with adjusted gross income of $10,000 or more, where the impact of income splitting is most important. At these levels, 90 percent of adjusted gross income is reported by married couples, and only about 7 percent by single persons.
Thus, income splitting covers so much income that it is for practical purposes an intrinsic part of the rate schedule. If the differential accorded to married couples is too great, the simplest and most plausible remedy is to reduce the tax rates on individual income, not to increase the rates on joint income. The former solution not only would disturb the status quo for fewer people, but also would have a lesser effect on total tax revenues, a virtue when the object of a tax change is technical reform rather than a shift in macroeconomic policy.

C. Recent Developments

1. Mitigation of the "penalty" for being unmarried.

Without explicitly saying so, Congress came close to accepting this analysis in 1969. Concluding that income splitting in its pre-1969 form created too great a disparity between married couples and other taxpayers, Congress chose not to repeal income splitting but to extend part of its benefits to unmarried taxpayers. In effect, income splitting was viewed as part of the rate structure, as it had been in 1951 when the HOH rates were prescribed. Indeed, the House version of the Tax Reform Act of 1969 simply expanded the 1951 allowance by allowing widows, widowers, and single persons over the age of 35 to file HOH returns, even if they had no dependents. On the Treasury's recommendation, however, the Senate substituted and Congress enacted a more inclusive but less generous remedy, consisting of a new rate schedule for unmarried taxpayers, regardless of age, under which their liability would not exceed a married couple's tax by more than 20 percent at any taxable income level. The Senate Finance Committee justified its rejection of the House proposal as follows:

The committee agrees with the House that the tax differential between single and married taxpayers is excessive but does not believe that the differential should be reduced only for single persons age 35 and over (and widows and widowers) as provided in the House bill. This age 35 test seems arbitrary and unrelated to the basic issue of whether there is too great a tax difference between single and married taxpayers resulting from marital status. In addition, there is good reason for maintaining a tax differential between single persons and heads-of-households who in fact maintain a household for a dependent. This distinction would, of course, be eliminated under the House bill. In view of these considerations, the committee substituted for the House provision the rate schedule which limits the tax paid by all single persons regardless of age to no more than 120 percent of the tax paid by married taxpayers at the same taxable income level.

108. The much-cited "revenue loss" of $21.5 billion from income splitting, see Stern, supra note 92, comes from Peckman & Okner, supra note 91. The figure represents the additional revenue that would be raised if the rate schedule of § 1(d) (married persons filing separate returns) were applied to all taxpayers, regardless of marital status. In fact, this schedule is used by only a comparative handful of taxpayers (see Table 4) and hence can hardly be regarded as the "standard" schedule.

For taxable incomes between $14,000 and $100,000, a range that embraces 17 percent of all taxable returns, a single person's liability is now from 17 to 20 percent above that of a married couple with the same taxable income.\footnote{110} For taxpayers above and below these brackets, the post-1969 disparity between single and married persons is smaller, because the tax effect of joint return income splitting is less pronounced at very low and very high income levels.\footnote{111}

The 1969 improvement in the position of single taxpayers was accompanied by a change in the tax treatment of married persons who elect to file separate returns. This practice was permissible before 1969, but it almost always generated a higher tax liability than a joint return, and hence was employed in cases of marital estrangement (e.g., if the more prosperous spouse wanted to avoid disclosure of his or her income to the other, or if the latter refused to sign a joint return\footnote{112}). When the single-person rates were reduced in 1969, however, separate returns would have become preferable to joint returns for many married taxpayers with relatively equal amounts of income, such as couples with two jobs or a community property residence. Recognizing that the use of separate returns by such persons would revive the pre-1948 geographical disparity between community property and common law states, as well as the opportunity to reduce taxes by intraspousal gifts of income-producing property, Congress rounded out the 1969 reform by denying use of the new single person rate schedule to married taxpayers filing separate returns. For this limited group of taxpayers, the pre-1969 single person rate schedule was preserved. Thus, separate returns are not more advantageous to married couples now than they were from 1948 to 1969.

2. The "marriage penalty."

Because married persons who file separate returns must use a special rate schedule rather than the one applicable to unmarried persons, the 1969 reform imposes a "marriage penalty" on persons with relatively equal amounts of income who get married and continue to have the same amount of income thereafter.\footnote{113} If John and Martha have taxable income of $16,000 each, for example, the pre-marriage tax is $3,830 each, or a

\begin{itemize}
  \item \footnote{110} See S. Rep. No. 91-552, supra note 109, at 260. Before the 1969 reform, the differential against single persons in these brackets ranged from 22% at $100,000 to 29% at $14,000 with a peak differential of 41% at $26,000. See id. at 261, Table 21.
  \item \footnote{111} The 1969 concession to single taxpayers was accompanied by a reduction of the rates applicable to HOH returns to preserve their historic midway position between the joint return and single taxpayer rates.
  \item \footnote{112} For other instances where separate returns may have been advantageous, see note 73 supra.
  \item \footnote{113} "Marriage penalties" were not unknown under pre-1969 law. The attribution rules, see notes 187-93 infra and accompanying text, for example, could and still can impose on unwary taxpayers penalties much in excess of the 1969 marriage penalty; indeed, the penalty is limited only by the size of the taxpayer's closely held corporation or other financial entity whose transactions bring
\end{itemize}
total of $7,660. If they get married and file a joint return, however, their liability will rise by $1,000, to $8,660. They are entitled to file separate returns if they wish, but that will not restore the status quo ante, since they are no longer eligible for the single-person rates that were formerly applicable to them. Instead, they must use the special rate schedule for married persons filing separate returns, which will impose a tax of $4,330 each, for a total of $8,660—the same amount as a joint return.214

The “marriage penalty” is most severe for middle- and upper-income taxpayers, reaching a maximum of $4,480 when each spouse has $35,000 of income. At any level, the penalty is most pronounced if the couple’s aggregate income is equally divided between them, but it is not inconsiderable even if the division is 60–40 or 70–30.115

Viewed in isolation, the penalty seems capricious and indefensible. But it is the unavoidable result of pursuing two policies, both of which have vigorous advocates, viz., (1) equal taxes for all equal-income married couples; and (2) a smaller differential between single and married persons than was provided by “pure” income splitting from 1948 to 1969. As explained earlier, if the allocation of income between two married persons is disregarded in order to impose the same tax on all married couples with the same aggregate income, marriage will inevitably either raise or lower the tax liability of all persons who get married, or raise it for some while lowering it for others. The operation of this ironclad rule is illustrated by Tables 1 and 2. Since Alpha and Beta paid a total tax of $2,000 before marriage, they will be subject to a marriage penalty if the tax on $20,000 of joint income is more than $2,000. But if the marriage penalty on Alpha-Beta is eliminated by imposing a tax of $2,000 or less on $20,000 of joint income, Theta and Zeta will be “penalized” for remaining single. Another way to describe this collision of objectives is that the tax paid by a married couple must be (a) greater than they paid before marriage, in which event they are subject to a marriage penalty, (b) less than they paid before marriage, in which event unmarried persons are subject to a singles penalty,

the attribution rules into play. The Treasury’s 1941 proposal for mandatory joint returns was also attacked as imposing a marriage penalty, see note 56 supra.


For a foreign parallel to the post-1969 marriage penalty in United States law, see N.Y. Times, Apr. 27, 1975, at 9, col. I.

114. The results described in the text are based on hypothetical amounts of taxable income, and therefore do not reflect another adverse affect on married couples of filing separate returns, viz., reduction in the standard deduction by virtue of the parenthetical restrictions in § 141(b) and 141(c). Before marriage, John and Martha would each have been entitled to a standard deduction of $2,000 in computing their taxable income; after marriage, they are limited to $2,500 on a joint return and to $1,000 each if they file separate returns. (As a result of 1975 changes in § 141, applicable to 1975 only, John and Martha would be entitled to a standard deduction of $2,300 each if unmarried, but to a deduction of $2,600 if they are married and file a joint return).

or (c) unchanged by marriage, in which event equal-income married couples are subject to unequal taxes.

From 1948 to 1969, the tax differential between single and married taxpayers imposed a “penalty” on being single.\textsuperscript{116} In 1969, the penalty was reduced for some single taxpayers and eliminated for others, but this reform had a price—either a penalty on some married couples or abandonment of the 1948 principle of imposing equal taxes on equal-income couples. Given this choice, Congress preferred the marriage penalty.

D. The Two-Job Married Couple

1. The problem.

In recent years, the two-job married couple\textsuperscript{117} has moved to the center of the stage in the ever changing but never ending drama entitled “Victims of Tax Injustice.” They are penalized, it is argued, by two aspects of the Internal Revenue Code. First, if they file a joint return, the second salary is added to the first in computing their combined taxable income, with the result that the first dollar of the second salary is taxed at the marginal rate applicable to the last dollar of the first salary.\textsuperscript{118} In form, this result can be avoided by filing separate returns, but the couple must then use a special rate schedule that, as just explained, is deliberately designed to prevent separate returns from reducing their aggregate tax burden.\textsuperscript{119}

Second, on leaving home to take a job, the second spouse usually incurs expenses—for transportation, more formal clothing, lunches, etc.—that cannot be deducted under today’s tax law.\textsuperscript{120} Yet the entire salary must be included in gross income. This results in a disparity between the couple’s statutory income and their economic gain, which is then widened by the working spouse’s inability to give as much time as formerly to maintaining the home, preparing meals, and shopping for bargains, so that the

\textsuperscript{116} The penalty on single persons was held constitutional in Kellems v. Commissioner, 58 T.C. 556 (1972), aff’d per curiam, 474 F.2d 1399 (2d Cir.), cert. denied, 414 U.S. 831 (1973).

\textsuperscript{117} I use the term “job” to refer to work outside the home, not to imply that work within the home is either easy or unproductive. This use of the term seems clear from the context, but sensitivities in this area are so great that one must tread warily. See generally 1973 JEC Hearings, supra note 92, at 228 (testimony of Grace Blumberg); id. at 234 (testimony of Carolyn McCaffery); Blumberg, supra note 113, at 49; Nussbaum, The Tax Structure and Discrimination Against Working Wives, 25 Nat’l Tax J. 183 (1972); Richards, Discrimination Against Married Couples Under Present Income Tax Laws, 49 Taxes 526 (1971); White, The Tax Structure and Discrimination Against Working Wives: A Comment, 26 Nat’l Tax J. 119 (1973).

\textsuperscript{118} This produces the marriage penalty that was just described. But the two-job couple’s complaint focuses on the marriage penalty imposed on earned income, often ignoring the fact that investment income is equally subject to a penalty if realized by the spouse who is not the breadwinner.

\textsuperscript{119} See notes 113–15 supra and accompanying text.

couple may have to hire a domestic servant, eat more frequently in restaurants, and pay more for goods and services. If they have young children, their economic gain from the second job will be eroded still further by the cost of caring for the children at home or in a day care center. Of these economic burdens, which are not borne by one-job married couples, the Internal Revenue Code permits only child-care expenses to be deducted, and this allowance is often less than the amount actually expended and is denied entirely if the couple’s adjusted gross income exceeds $44,600.122

In combination, these features of existing law mean that the two-job couple is taxed on the gross amount of the secondary salary even though their economic gain is less than that amount, and at a higher rate than is paid by a single person receiving the same salary.122 Assume, for example, that a married woman is offered a job paying $10,000 a year, which will increase the couple’s taxable income from $14,000 (attributable to the husband’s earnings) to $24,000. Under 1975 rates, their taxes will rise by $2,900. If we assume that the wife’s transportation to work, lunches, and clothing, part-time domestic service, occasional restaurant meals, and reduced opportunities to shop for bargains increase the couple’s living expenses by $3,500, the wife’s $10,000 job will produce only $3,600 of after-tax economic gain. At higher income levels, where the couple’s accustomed way of life is even more expensive to maintain and the applicable marginal tax rate is higher, the second salary may be even more severely eroded. A plausible example offered by a critic of existing law involves a married woman whose $10,000 salary yields a net of only $1,600.123

122. See § 214. By virtue of a 1975 amendment the phase-out begins at $35,000 and wipes out the deduction entirely at $44,600; the corresponding figures under the pre-1975 law were $18,600 and $27,600.


122. See 1973 IEC Hearings, supra note 92, at 229 (testimony of Grace Blumberg), setting out this hypothetical case: Mrs. X is married to a young executive making $15,000 per year. She is offered two jobs: an industrial job that promises long hours and pays $75,000; and a college teaching job with flexible hours and a salary of $10,000. Since Mrs. X feels that she must bear primary responsibility for the home duties, she considers only the teaching job. She calculates that it would cost $2,400 per year for day care for her child; $2,000 a year for a suitable wardrobe, $500 a year for lunch, $600 for commuting, and $500 for miscellaneous expenses (e.g., larger reliance on convenience foods).

Mrs. X finds that family expenses will increase $5,000 if she returns to work. Her income will be taxed at her husband’s marginal rate. His taxable income is $8,000 so her first dollar will be taxed at 22%. Her employment will therefore increase the family’s federal income tax bill from $3,380 to $3,820 (1972 rates); her share of the bill is $2,440. If State and local taxes average 5%, her cost is $500. Social security taxes amount to another $486 (1972 rates). Mrs. X’s gross income will yield a net of $1,522.
These burdens on the two-job married couple are often castigated as a deterrent to the employment of married women outside the home. In theory, of course, the burden arises whether the "secondary" wage-earner is the husband or the wife, and hence falls on the couple jointly. In a society that takes the husband's job for granted and views the wife as the secondary wage earner, however, it is reasonable to describe the existing state of affairs as biased against women.

With these illustrations of the impact of existing law before us, it should occasion no surprise that a plethora of solutions have been proposed for the situation of the two-job couple. This is not the place to analyze their details. I propose rather to examine the premises of the most commonly mentioned remedies and to show how—as so often in this complex area—there are offsetting costs to every solution.

2. An earned income allowance?

One group of solutions for the plight of the two-job married couple seeks to narrow or eliminate the gap between the dollar amount of the second salary and the before-tax net economic gain it produces. The most sweeping version of this approach would be a deduction for all expenses attributable to the fact that both spouses, rather than only one, are working—not merely such job-related expenses as transportation and lunches, but also expenses resulting from the secondary wage earner's loss of time and energy for household services.

But how could such an allowance be verbalized or administered? Every two-job married couple would be tempted to assert that but for the wife's job, she would have done all of the housework, made the family's clothes, cultivated a home garden, consulted Consumers' Reports every day, and bought whatever the family needed at end-of-season clearance sales, and that the cost of the goods and services required to replace these activities qualifies for the proposed deduction. There may be people who live, rather than merely fantasize, the life reflected by the Whole Earth Catalogue. Faced by a married couple's assertion that "But for our two jobs, etc.

124. Finding that wives are less likely to work outside the home than husbands, Michael Boskin argues that a lower tax rate on the earnings of working wives would induce a more efficient use of social resources. *See M. Boskin, Optimal Tax Treatment of the Family*, Stanford University Research Center in Economic Growth, Research Memoranda No. 143 (1973). Boskin's intriguing proposal for rate schedules differentiated by reference to the elasticity of the supply of particular types of labor would be applicable to other secondary wage earners (e.g., children living with their parents). Because of these additional ramifications, as well as its dependence on the validity of labor market statistics, the idea needs much more analysis before being placed on an active legislative agenda.

125. Indeed, a similar allowance could be claimed with about equal plausibility for the working wife's loss of leisure, even if she frankly admits that but for her job, she would have engaged in social or aesthetic, rather than money-saving, activities. The loss of time is real, whether it would have been used to save money or to attain other objectives, but measuring the loss in dollars is easier if one hypothesizes a money-oriented use of the lost time.
that would be our lifestyle," should a conscientious revenue agent accept
the return as filed, administer a dose of truth serum, or give the secondary
wage earner a battery of vocational and psychological tests to determine
whether the couple could be self-sufficient if they were not holding two
jobs?

An inquiry by the Internal Revenue Service into the way married
couples would have lived if one spouse had remained at home would be
an intolerable intrusion into their personal life if relentlessly pursued. But
passive acceptance of self-serving declarations would invite shameless ex-
aggeration. Administration of the child-care deduction of Section 214 con-
tains the seeds of trouble, which grow with every relaxation of its statutory
restrictions. Possibly because of this threat to privacy, the Internal Reve-
nue Service has never seriously endeavored to determine whether a tax-
payer hired a babysitter in order to work, worked in order to hire a baby-
sitter, or would have hired a babysitter anyway, even though expenses are
deductible under Section 214 "only if . . . incurred to enable the taxpayer
to be gainfully employed."126

Furthermore, any allowance based on actual increases in the taxpayer's
cost of living attributable to employment would overlook the fact that the
additional expenses, even if not wholly voluntary, ordinarily generate some
"personal" benefits. The two-job couple may be forced to eat in restaurants
more frequently than they otherwise would, but it is possible that they enjoy
this way of life; similarly, relief from housework is afforded by a two-job
couple's employment of a domestic servant. This dual aspect of expenses
on the personal-business borderline is, in general, disregarded for travel,
meals, and entertainment in the pursuit of business; such expenses can be
deducted in full even if the taxpayer derives personal pleasure from these
business-related activities.127 But this feature of existing law is open to
abuse, is often criticized, and is, at best, hardly a virtue to be emulated.

For these reasons, an open-ended earned-income allowance for all ex-
penses resulting from the secondary wage earner's employment is not
likely to gain acceptance. A more plausible proposal is a deduction or
credit of an arbitrary amount (related to the earnings of the spouse with
the lower salary), based on a presumption that the couple would have
lived more modestly if the second spouse had not been employed outside
the home. The allowance would be given without regard to whether the

126. The Treasury Regulations suggest that the necessary nexus between employment and child-
care expenses may be absent if the wife's earnings are less than the expenses. Treas. Reg. § 1.214-
1(f)(4)(1971). But this seems to be the only hint of an attempt by the Internal Revenue Service to
determine whether the domestic servant would have been employed even if the wife did not work
outside the home.

127. See generally §§ 162(a), 212, 274; B. Bittker & L. Stone, supra note 101, at 233-76;
Klein, supra note 120, at 878.
presumption is in fact true in the individual case. Pechman, for example, has suggested either a deduction (not to exceed $2,500) of 25 percent of the second salary or a credit (not to exceed $1,000) of 10 percent of the second salary. Many variations on these proposals are obviously possible.

Whatever the details, however, the concept of an earned-income credit solely for two-job married couples is curiously narrow. Everyone who works away from home—not just the working wife—must get to the job site, dress as the job requires, and pay for lunch if it is inconvenient to bring it in a brown bag. Similarly, everyone who works has less time and energy to keep house, prepare meals, and look for bargains. Employment increases the cost of living for unmarried persons who live alone, as well as for two-job married couples; even for the one-job married couple, the primary earner's salary is burdened by these costs, so that they are at a disadvantage as compared with married couples who live entirely on investment income or pensions. In short, employment, not marital status, produces the disparity between statutory income and economic gain that constitutes one count in the two-job couple's indictment of existing law.

This analysis suggests that if a tax allowance for these expenses is warranted (either to measure the employee's "income" more accurately or to eliminate a disincentive to employment), it should embrace all employed taxpayers, not merely two-job married couples. Indeed, this reasoning was accepted during the years when an earned-income deduction was authorized by Congress (1924-1931 and 1934-1943); all taxpayers receiving earned income were eligible, regardless of their marital status.5

Because nearly 90 percent of all adjusted gross income reported on federal tax returns consists of salaries, wages and self-employment income; however, an earned-income allowance would be enjoyed by virtually all taxpayers. If the cost of the allowance were to be recouped by increasing taxes on investment income, its enactment would serve the intended function of reducing a tax barrier to employment, but if the lost revenue were to be recouped by a general increase in rates—a more likely outcome, one suspects—the government would be robbing Peter to pay Peter.

This self-defeating aspect of a universal earned-income allowance would not arise in an allowance restricted to two-job married couples, since

128. 1973 JEC Hearings, supra note 92, at 254 (testimony of Joseph Pechman). For the temporary earned income credit enacted in 1975, see note 129 infra.
129. See 3 R. PAUL & J. MERTENS, LAW OF FEDERAL INCOME TAXATION §§ 30.16-21 (1934). In 1975, just as this Article was going to press, Congress enacted § 43, providing an earned-income credit of 10% of earned income for taxpayers with households that include a dependent child. The credit is granted only to taxpayers with adjusted gross income of under $8,000 (but will be paid in cash if it exceeds the taxpayer's actual tax liability), is subject to a ceiling of $500, and is to be effective for only one year.
it would probably be financed by taxing a much larger circle of taxpayers. Such a restricted allowance might be defended on the ground that, at least for many families in moderate circumstances, only one spouse is compelled by economic pressure to work outside the home, the second spouse—usually, in our society, the wife—being free to choose between unpaid housework and remunerative employment. Having this choice, she will be deterred—so the argument proceeds—from seeking a job outside the home, regardless of her talents and inclinations, unless the tax laws are changed to provide an earned-income allowance.

Advocates of a restricted earned-income allowance are not opposed in theory to an extension of the allowance to other employees. They contend rather that the working wife’s plight is exceptionally deserving of a remedy, and that a generous allowance for the two-job couple would be preferable to a less generous allowance spread among all employees. Is it not better for the Ford Foundation to give a lot of money to a few institutions than to buy a glass of beer for everybody in the world?

It may well be that the disparity between the employee’s gross salary and the cash left after defraying employment-generated expenses is more discouraging to wives than to other taxpayers, though this disincentive is obviously outweighed by economic pressure or personal inclination for the millions of wives who are already employed outside the home. What is far less clear is the extent of the deterrence. At most, a tax allowance would be a partial offset to the employment-generated expenses that may be deterring these wives from joining the labor force; it would not reimburse them in full. Thus, if the two hypothetical couples described earlier were eligible for the deduction proposed by Pechman, the after-tax economic gain generated by the working wife’s $10,000 salary would rise by about $800—from $3,600 to about $4,400 for the first couple and from about $1,600 to about $2,400 for the second. The credit proposed by Pechman would provide slightly more relief—an additional $200 for each couple. These benefits would not be refused by the two-job married couple, of course, but neither would they constitute a major economic breakthrough for the housewife. Furthermore, even these modest allowances would cost $2.5 to $3 billion at current income and tax levels. More substantial tax concessions, designed to neutralize the added costs of the secondary wage

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131. U.S. BUREAU OF THE CENSUS, U.S. DEP’T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 327 (1972 ed.). The table indicates that there were 20,281,000 wives working as of March 1971.

132. 1973 JEC HEARINGS, supra note 92, at 254 (testimony of Joseph Pechman). If employment increased as a result of the tax allowance, some of the revenue loss would be recouped from the additional wage-earner income. The 1975 earned-income credit described supra note 129 is estimated to cost $1.5 billion, despite the severe restrictions on eligibility. TREASURY DEPARTMENT, TREASURY NEWS 3 (Mar. 1975).
earner's employment rather than merely mitigate existing law, would obviously entail a far larger revenue loss.

On balance, I would conclude that employment-generated expenses are a deterrent to employment outside the home for some wives, especially at higher income levels, but that their inability to deduct these expenses in computing tax liability accounts for only a modest fraction of this deterrent. An acceptable tax allowance would alleviate such a small part of this already modest fraction that the number of working wives would probably not be much affected by the change. Of course, an allowance might be taken as a symbol, however minor its financial value, of Congressional "approval" of employment outside the home, but if this is its primary virtue, it should be proposed not as a permanent part of the tax structure, but rather as a transitional device to be phased out as obstacles to the employment of wives are eliminated. If forced to predict the future of such an allowance, however, I would expect it to be attacked as a penalty on unmarried persons unless expanded to embrace all gainfully employed taxpayers, rather than praised as a transitional measure for the working wife.

3. Separate returns for married couples?

As explained earlier, the tax burden on the two-job married couple is created by two features of today's law—nondeductibility of the increase in their expenses resulting from the wife's decision to work outside the home and the fact that her earnings are either aggregated with her husband's income in computing their tax liability on a joint return or subjected to a disadvantageous rate schedule if she files a separate return. The first of these features of today's law, as we have seen, is applicable to anyone who works, not merely to the working wife, and this weakens the case for a remedy that is confined to the two-job married couple. But the second—aggregation of both spouses' incomes if they file a joint return, with the alternative of an unfavorable separate return—is peculiar to married couples. This analysis suggests that the status of two-job married couples could be improved by altering the Hobson's Choice (aggregation on a joint return versus an unfavorable rate schedule if they file separate returns) now confronting them.

The remedy might take the form of permitting married couples to use the rate schedule applicable to unmarried persons if they elect to file separate returns, rather than compelling them to use the less favorable rate schedule that is now applicable to married persons filing separately. For the wife contemplating a job outside the home, this proposal would equalize her tax with that of an unmarried person receiving the same salary,
assuming that they are entitled to the same exemptions and deductions.\textsuperscript{133} To be sure, the proposal would give her no tax allowance for the increased expenses attributable to her employment, but in this respect her position would be the same as that of an unmarried employee. For two persons contemplating marriage, the proposal would eliminate the marriage penalty of existing law, since after marriage they could continue to file separate returns and pay the same tax as before marriage. Conversely, a tw o-job married couple could not reduce their taxes by divorce.

Appealing though it may be to eliminate simultaneously the tax penalty on marriage and the tax reward for divorce, this package should not be purchased without examining its price tag. The price tag, in brief, is abandonment of the 1948 principle of imposing the same aggregate tax on all equal-income married couples, regardless of how the two spouses contribute to their joint income. The tax liability of married couples would once again depend, as it did before 1948, on the amount of income attributable to each spouse.

The achievement of equality in taxes between married couples with the same income has been so commonly regarded as a permanent part of our tax structure—adopted in 1948 "for all time"\textsuperscript{134}—that its abandonment by a current legislative proposal, sponsored by a politically diverse spectrum of more than 150 Congressmen and Senators, is nothing less than astonishing.\textsuperscript{135} Their bill would establish a single rate schedule for all taxpayers, with the result that married persons would have to file separate returns and pay taxes based on their individual incomes.\textsuperscript{136} This would, of course, revive the disparity in tax liability among equal-income married couples that prevailed in common law states before 1948. But it would go further, by creating similar disparities in community property states where they have never existed.\textsuperscript{137} This is because couples in community property states

\textsuperscript{133} If the wife's income is very small in proportion to their joint income, however, the use of separate returns would increase their aggregate tax liability (e.g., tax on joint income of $40,000 is $12,140; taxes on separate incomes of $35,000 and $4,000 are $12,290 and $590, or a total of $12,880). In situations of substantially disproportionate contributions to the joint income, a couple would pay the same on separate returns as they would have paid before marriage but would lose the tax advantage now conferred on married couples by the joint return rate schedule. See §§ 1(b), 1(d).

\textsuperscript{134} See Pechman, \textit{supra} note 1, at 475.

\textsuperscript{135} See H.R. 715, 93d Cong., 2d Sess. (1974), which incorporates two bills introduced in the 92d Congress, H.R. 850 and H.R. 14193. For a list of co-sponsors of these earlier measures see 1972 \textit{House Hearings}, \textit{supra} note 10, at 97.

\textsuperscript{136} If H.R. 715 were enacted, the income of a secondary wage earner would no longer be added to the primary breadwinner's income and be taxed at the latter's marginal rates, but would instead be taxed in its own right at the starting rates applicable to the income of single persons. But H.R. 715 does not authorize the secondary wage earner to deduct the increased expenses caused by joining the labor force. See notes 120-21 \textit{supra} and accompanying text. By leaving this aspect of existing law intact, it tacitly confirms the argument that these expenses are the result of employment, rather than marital status. See text accompanying note 128 \textit{supra}.

\textsuperscript{137} In the interest of pedantry, a few minor exceptions must be noted: before \textit{Poe v. Seaborn}, 282 U.S. 101 (1930), see note 36 \textit{supra} and accompanying text, community income was not always
TABLE 5
AGGREGATE TAX LIABILITY OF MARRIED COUPLES FILING SEPARATE RETURNS UNDER PROPOSED LEGISLATION

<table>
<thead>
<tr>
<th>Income Ratio</th>
<th>$16,000</th>
<th>$32,000</th>
<th>$64,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. 100-0</td>
<td>$3,260</td>
<td>$8,660</td>
<td>$24,420</td>
</tr>
<tr>
<td>2. 75-25</td>
<td>2,880</td>
<td>7,040</td>
<td>19,320</td>
</tr>
<tr>
<td>3. 50-50</td>
<td>2,760</td>
<td>6,520</td>
<td>17,320</td>
</tr>
</tbody>
</table>

Note: Based on 1974 joint return rate schedule; the dollar amounts of tax, but not the principle, would be different under any other schedule. For simplicity, computations are based on taxable income rather than AGI, thus ignoring effect of deductions.

would not be permitted to divide their earned income equally when filing separate returns, but instead would have to attribute it to the taxpayer performing the services. The purpose of this requirement is to avoid reinstating the pre-1948 tax advantages of residence in community property states. But to achieve this understandable objective, the legislation imposes unequal tax burdens on equal-income married couples in community property states, in place of the equality that prevailed in these states before 1948.

The effect of the legislation just described on married couples with $16,000, $32,000, and $64,000 of taxable income, divided between them in varying proportions, is illustrated by Table 5.

Can these variations in the tax liability of equal-income married couples be justified? One type of variation—the lower tax on the two-job couples in Cases 2 and 3 than on the comparable one-job couple in Case 1—is of course the central purpose of the proposed legislation, which is concerned with the two-job couple’s “wage earner” expenses and loss of untaxed household services by virtue of the secondary wage earner’s job. But what justifies the variation between Case 2 and Case 3 taxpayers, who are both two-job couples? If the income is divided 75–25 in Case 2 but 50–50 in Case 3 because the secondary wage earner in Case 2 works shorter hours, the difference between them might reflect lower wage earner expenses or a greater opportunity to perform part-time household services (or both) in Case 2 than in Case 3. But if the secondary wage earner in equally divisible between the spouses, at least in the eyes of the Internal Revenue Service, and community property couples with separate income were, pro tanto, subject to tax disparities similar to those of couples in common law states.

138. For the 1969 frequency distribution of various husband-wife earning ratios, by adjusted gross income classes, see 1972 House Hearings, supra note 10 at 81, table 1 (testimony of Hon. Edwin S. Cohen). Cohen’s figures show that in over 50% of all cases the lower-earning spouse earns nothing, while in over 70% of the cases the lower-earning spouse earns less than 20% of the higher-earning spouse’s income. In less than 10% of the cases does the lower-earning spouse earn from 41% to 50% of the higher-earning spouse’s income.

139. See note 123 supra and accompanying text.
both instances is engaged in full-time employment, it is harder to justify
a differential in tax liability. If the secondary wage earner's domestic ser-
cess would be more valuable in Case 3 than in Case 2, a lower tax on Case
3 couples could perhaps be defended as compensation for the greater loss
attributable to deprivation of these services, but the factual predicate for
this argument is quite dubious.

Table 4 illustrates another aspect of the proposed legislation—the fact
that its benefits rise with income. It may be that some expenses of the sec-
ond spouse's employment (e.g., the cost of suitable clothing) rise similarly,
but it is less likely that the value of the lost housekeeping services rises
progressively with the salary that the secondary wage earner can command
on leaving the home. Indeed, at the top of the income pile, where the
benefits of the proposed legislation would be greatest, a typical married
couple may spend as much for domestic help when one spouse works as
when both work, and the wife's entry into the labor force may not signifi-
cantly increase her expenses for lunches, clothing, transportation, and other
job-related items. Yet under the proposed legislation, a couple with
$100,000 of earned income would pay about $45,000 if the income is en-
tirely attributable to one spouse, about $36,500 if it is divided in the ratio
75–25, and only $34,000 if it is equally divided between them.

In discussing the proposed uniform rate schedule for single and mar-
rried taxpayers, I have focused on its effect on two-job couples. In fact, the
legislation is not so limited; it applies to investment as well as earned in-
come, and therefore embraces no-job and one-job married couples as well
as two-job couples. For taxpayers with investment income, its impact would
depend on the way their income was divided inter sese and their willing-
ness to alter this proportion to save taxes. In discussing the effect of the
proposed legislation on earned income, I pointed out that the tax differ-
entials illustrated by Table 4 are not very precisely related to economic
differences between one-job and two-job married couples, or between two-
job couples who receive their income equally and those whose earnings are
disparate. But the differentials are even harder to justify if all or a substan-
tial part of the income is from investments rather than personal services;
the tax savings attributable to an equal division of investment income be-
tween husband and wife (which produces the lowest tax) may reflect the
fact that they inherited equal fortunes, rather than that they are employed
outside the home at equal salaries. Moreover, if their income is not realized
in the most favorable ratio (50–50), they can reshuffle it by gifts of their
income-producing property, either to equalize their investment income if
their earned income is already equal (or zero) or to counterbalance the

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140. See notes 121–26 supra and accompanying text.
effect of unequal amounts of earned income. No comparable opportunity to approach or reach a 50-50 split is open to couples with income derived solely from personal services, however, since an assignment of such income is ineffective under Lucas v. Earl.

By rewarding couples who divide their income-producing property so as to equalize their income, the proposed legislation would abandon a major, almost universally praised result of the 1948 income-splitting joint return—the irrelevance of “bedchamber” transfers of property. During the 1930’s and 1940’s, one ingenious husband-wife arrangement after another was invented by private tax lawyers in an effort to shift investment income from one spouse to another without a corresponding change in ownership or control of the underlying property, while their equally resourceful counterparts in the Internal Revenue Service contested these devices with every legislative, administrative, and judicial weapon in the government’s arsenal. Both sides laid down their arms in 1948 when the attribution of income between husband and wife became irrelevant if they filed a joint return. To be sure, there have been continued skirmishes over the validity of parent-child and other donor-donee transfers. But for emotional and prudential reasons, these transfers are likely to be smaller in amount and less frequent than husband-wife transfers, and hence they impose less stress on the tax system’s enforcement machinery.

The proposed separate-return legislation would revive another source of turmoil that has been quiescent since 1948—the allocation of deductions between husband and wife. Income-related items can be assigned with

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141. It has been argued that this is a minor matter because persons who are prone to tax avoidance have already shifted their investment income to children. See 1973 JEC Hearings, supra note 92, at 233 (testimony of Grace Blumberg). I doubt the validity of this factual assertion; transfers of property to children have always been more deterred by fears of ingratitude than transfers to a spouse. Countermeasures can be drafted (e.g., taxing investment income to the donor in specified circumstances even if no strings were retained), but their acceptability is another matter. For another remedy, see note 143 infra.


143. For a proposal to eliminate the marriage penalty on earned but not investment income, see S. 3826, 93d Cong., 2d Sess. (1974). For a discussion of the concept see 1973 JEC Hearings, supra note 92, at 147 (testimony of Oscar Gray). See also 120 Cong. Rec. 14805-06 (daily ed. Aug. 15, 1974) (remarks of Senator Mathias). As drafted, the legislation overshoots its objective by computing a hypothetical marriage penalty that in some instances exceeds today’s actual penalty (e.g., husband with $24,000 of earned income and $12,000 of investment income, wife with $8,000 of earned income—actual penalty under 1974 rates is $180, but allowance would be $280). This defect could be corrected by a complex technical change, but the amount of the allowance could then be altered by transfers of income-producing property from one spouse to the other. Moreover, like the legislation illustrated by Table 5, S. 3826 would confer differential benefits on equal-income, two-job couples, the benefits depending on the ratio of one spouse’s earned income to the other’s. S. 3826 also would require the allocation of deductions between husband and wife. For a discussion of this problem, see note 144 infra and accompanying text.

144. Prior to 1948, deductions were presumably attributable to the taxpayer who incurred the expense and not to the taxpayer who eventually paid it. See, e.g., Robinson v. Commissioner, 53 F.2d 810 (5th Cir. 1931) (holding that the voluntary assumption of the liability of another does not give rise to a deduction as an “ordinary and necessary business expense,” “business loss,” or “tax paid”).
relative ease to the spouse whose income generated the expense, though the allocation of interest on debt for which they are jointly liable and some other items could be troublesome. The principles for allocating itemized personal deductions are less evident, however, and it might be necessary to assign them in the ratio that each spouse's adjusted gross income bears to their joint adjusted gross income. This seems arbitrary as to items that bear a special relationship to one spouse rather than the other (e.g., alimony, interest on property held in separate ownership, contributions to one spouse's college, and employee moving expenses), especially if they maintain separate financial accounts. Since dollars are fungible, such intra-spousal bookkeeping is quite artificial, but the very concept of separate tax returns requires a pretense of financial separatism.

4. Conclusion.

The search for a remedy for the two-job couple's complaint has taken us far afield. They incur expenses that are not incurred by the one-job married couple, but on analysis it turns out that these stem from employment, not marital status, thus casting doubt on the fairness of a remedy that is confined to the two-job married couple. At the same time, a more inclusive earned-income allowance, granted to all gainfully employed taxpayers, would grant no distinctive relief, nor would it be of symbolic value, to the working wife. Moreover, while the great cost of such an allowance could in theory be recouped solely from taxpayers with unearned income, it is more likely that some and perhaps most of the cost of recoupment would be imposed on the very taxpayers who get the allowance.

The other principal approach to the complaint of the two-job married couple is also fraught with troublesome issues. The enactment of a single rate schedule for all taxpayers, regardless of their marital status, would restore some or all of the tax rules applicable to family income before 1948. Depending on the details of the legislation, this would mean (a) unequal tax burdens for many equal-income married couples, depending on whether their income stems from one job, two jobs, investments, or a combination of earned and unearned sources; (b) restoration of the tax advantages of residence in community property states—or, as a device to eliminate these advantages, the development of rules attributing community income to one spouse rather than equally to both;445 and (c) revival of the problem

The test as to the allocation of dependency deductions centered on who actually paid for the support of the child.

The allocation rule after 1948 is that a taxpayer will be allowed a deduction only for expenses actually paid. See, e.g., Rev. Rul. 59-66, 1959-1 Cum. Bull. 60 (holding that where the husband and wife maintain a joint checking account in which each apparently has an identical interest, there is a rebuttable presumption that the expenses paid from the account are paid equally by the two parties).

145. Analogous attribution rules are currently found in § 911(e)(3) (exclusion of income earned by nonresident; amount computed without regard to community property laws applicable to the
of income splitting between spouses, a subject that has been virtually quiescent since 1948, along with the related problem of allocating deductions between the two spouses.

E. Summary

Part III of this Article has been concerned with the bearing that the following factors might have on the relative taxpaying capacities of single persons and married couples:

1. An obligation to support two persons.
2. The enjoyment of economies of scale in housing, food, etc.
3. The benefit of untaxed household services.
4. Expenses of commuting to work, dressing to suit the job, etc.

A plausible case can be made for taking each of these characteristics into account in fixing tax liabilities. But a major theme in the foregoing discussion was that none is unique to married couples. Table 6 illustrates this troublesome fact by indicating the extent to which these factors are characteristic of each of nine patterns of domestic life. Inspection of Table 6 discloses that only two of these nine variations possess identical characteristics (viz., a single wage earner living with a nonemployed dependent and a one-job married couple). The table is confined to one-person and two-person households; expanded to embrace larger groups, it would present an even more complex array.

Thus, the characteristics that, in the view of important segments of public opinion, affect taxpaying capacities and hence ought to be taken into account in fixing tax liabilities are dispersed like patches in a crazy quilt. Every legislative disposition of the issues must distinguish between taxpayers with equally plausible claims, and is therefore virtually fated to be both overinclusive and underinclusive when judged from one perspective or another. It follows that there can be no peace in this area, only an uneasy truce.

146. See J. Pechman, Exercise on the Tax Treatment of the Family, Jan. 14, 1972 (unpublished paper on file with author). In this imaginative essay Pechman asks the reader to resolve a deadlock in a task force of tax lawyers and economists who have been appointed by a hypothetical President-elect to devise a new federal income tax before his inauguration. The experts cannot agree on the proper differentiation among families of different size, composition, and number of earners. The reader, therefore, is asked by Pechman to recommend the tax liability to be imposed on each of six categories of family units (single person without dependents, one-job childless married couple, widow with one child, two-job childless couple, two-child, one-job married couple, and four-child, two-job married couple) at 5 different income levels.
TABLE 6
Dispersion of Factors Affecting Taxpaying Capacity Among Diverse Household Patterns

<table>
<thead>
<tr>
<th></th>
<th>Months to Feed</th>
<th>Economies of Scale</th>
<th>Imputed Income</th>
<th>Wage earner Expenses</th>
</tr>
</thead>
</table>

1. Single person
   (a) Employed
      (1) Living alone 1 No No Yes
      (2) Sharing expenses with non-dependent employed roommate 1 Yes No Yes
      (3) Living with nonemployed dependent 2 Yes Yes Yes
   (b) Nonemployed (investment income)
      (1) Living alone 1 Yes No
      (2) Sharing expenses with non-dependent employed roommate 1 Yes Yes No
      (3) Living with nonemployed dependent 2 Yes Yes Yes No

2. Married couple
   (a) Neither spouse employed (investment income) 2 Yes Yes Yes No
   (b) One spouse employed 2 Yes Yes Yes
   (c) Both spouses employed 2 Yes No Yes Yes

Note: "Yes-Yes" denotes 2 persons with the relevant characteristics.

III. Dependency Exemptions

A. Background

The Revenue Act of 1913 granted every taxpayer a personal exemption of $3,000, plus an additional $1,000 if married, and this special allowance was extended by the Revenue Act of 1916 to any "head of a family," but neither act made any separate provision for the taxpayer's children or other dependents. In 1917, however, Congress authorized the head of a family to deduct $200 for each dependent child under the age of 18 or incapable of self-support because mentally or physically defective. In later years, this allowance was gradually broadened in scope and increased in amount. Now set at $750, it embraces a wide variety of persons who (a) are either related to the taxpayer by blood, marriage, or adoption, or reside with him as a member of his household, (b) receive over half of their support for

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149. § 151(b).
### TABLE 7

**Dependency Exemptions Claimed on 1970 Personal Tax Returns**

<table>
<thead>
<tr>
<th>Type of Dependent</th>
<th>Number of Returns (in Thousands)</th>
<th>Number of Exemptions (in Thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Children living at home</td>
<td>31,427</td>
<td>73,754</td>
</tr>
<tr>
<td>Other children</td>
<td>570</td>
<td>1,023</td>
</tr>
<tr>
<td>Parents</td>
<td>1,638</td>
<td>1,747</td>
</tr>
<tr>
<td>Others</td>
<td>1,204</td>
<td>1,622</td>
</tr>
<tr>
<td><strong>Total exemptions</strong></td>
<td><strong>78,146</strong></td>
<td><strong>78,146</strong></td>
</tr>
</tbody>
</table>

*Source: U.S. DEP'T OF TREASURY, 1970 Statistics of Income 107, Table 21 (1972). Total of first column exceeds 33.5 million because some returns claimed more than one type of dependent.

The gross-income restriction is, in general, not applicable to children of the taxpayer who are under the age of 19 or who are full-time students, and the other requirements are also subject to many refinements and qualifications. Of the 74.3 million returns filed in 1970, 33.5 million returns claimed a total of 78.1 million dependency exemptions, the overwhelming majority of which were for children living at home, as Table 7 indicates.

It is a reasonable inference that most of these dependency exemptions are for children whom the taxpayer is legally obligated to support. But some are for adult children and other persons, who qualify for the deduction even though the taxpayer’s contributions are prompted not by legal compulsion but by moral responsibility, family pressure, generosity or other impulses that only a psychoanalyst could expose.

### B. Propriety of the Exemption

There is no consensus on the propriety of tax allowances for dependents, but four positions can be described.

#### 1. Dependents as “consumption.”

At one extreme, amounts spent by the taxpayer for the support of others are said to be a form of pleasurable consumption, a characterization implying that these expenditures are no more entitled to a tax allowance than the cost of the taxpayer’s food and clothing. Even if the dependents are...
the taxpayer's children, whom he is compelled by law to support, the ex-
penditures are said to be an indulgence in personal preferences because the
decision to procreate is voluntary. (Even before the advent of the Pill, it
was argued that couples who preferred action to abstinence should not be
rewarded by the Treasury.) Financial aid to the taxpayer's brothers, sisters,
and more distant relatives is even more voluntary than a parent's support
of minor children, since it can be terminated at any time without breach-
ing a legal obligation. The only dependency allowance that can survive
this dependents-as-consumption analysis is a provision for the cost of sup-
porting the taxpayer's parents under legal compulsion; until modern tech-
nology enables taxpayers to avoid having parents, these payments will
entail no voluntary choice, except abstention from parricide.

Although advocates of the dependents-as-consumption theory ordinari-
ly are willing to tolerate a tax allowance for the cost of supporting minor
children at the subsistence level, a rigorous application of the theory would
exclude even this concession. If the parents have more than enough income
to support themselves, why not tax them, and remedy any resulting de-
ficiency in the children's standard of living by governmental grants at the
normal welfare level? Another corollary of the dependents-as-consump-
tion theory (not noticed, so far as I can recall, in the literature) is that
the dependent should be taxed on expenditures for his support, as though these
amounts were the price charged by him for providing the personal satis-
fac-tions "consumed" by his patron. For example, the price of a theater
ticket is simultaneously a nondeductible consumption expenditure by the
playgoer and taxable income to the paid entertainer, and expenditures for
the support of dependents arguably serve the same dual function.

In point of fact, theorists espousing the dependents-as-consumption ar-
gument do not ordinarily press it to its dryly logical extreme. The ambiv-
alance of Henry Simons is a good example of the latitudinarian attitude
of a sensible man. Thus, in an extended discussion of the tax treatment of
dependents, he says that "one is tempted to urge substantial concessions"

140 ("it would be hard to maintain that the raising of children is not a form of consumption on the
part of the parents—whether one believes in subsidizing such consumption or not"); Bridges, Family
Need Differences and Family Tax Burden Estimates, 24 Nat'l Tax J. 423, 424 n.8 (1971) ("having
children voluntarily can be viewed as a form of consumption by the parents"); I do not mean to sug-
gest that these authors consistently oppose all allowances for family responsibilities, but they usually
are hostile to tax allowances for consumption expenditures, and seldom offer any grounds for dis-
tinguishing among forms of consumption.

154. Protagonists of the theory that direct government subsidies are more efficient and equitable
than, and should therefore replace, tax allowances have not yet listed this proposal on their agenda,
but let us not be impatient. The Tax Expenditure Budget for the fiscal year 1976 lists dependency
exemptions as tax expenditures only as respects "student age 19 or over" (which appears to be a
shorthand reference to children who are either full-time students or 19 years of age and who are
themselves claiming a personal exemption for their income) but not other dependency exemptions.
Office of Management and Budget, Special Analyses, Budget of the United States Govern-
for taxpayers supporting "numerous dependents," that the credits for minor dependents "should vary directly with the family income," and that there should be "generous deductions" for the support of persons outside the taxpayer's household. But then Simons argues for an income tax graduated by reference to the taxpayer's "periodic accretions of means, and with relatively little regard for the manner in which the means are employed." Next we are told that "as a matter of principle, gifts are consumption to the donor and therefore not properly deductible," that "it would be hard to maintain that the raising of children is not a form of consumption on the part of parents," and that "[i]f the training of a few children is made the object of expenditures involving a disproportionate share of the community's resources, that . . . is something which the rules of the game should not encourage." Finally, when Simons moves from these observations to his recommendations for legislative action, he says that his argument does not imply disapproval "of small, fixed credits with respect to minor children or others who are incapable of self-support and are, in fact, primarily dependent on the particular taxpayers" and that "small and fool-proof concessions of the kind now [1938] commonly made are not incompatible with reasonably close adherence to simple general rules." Thus, despite his advocacy of the dependents-as-consumption theory, Simons evidently did not object (at least as respects minor children) to the dependency allowance in force in 1938, which authorized a deduction of $400 for every person under 18 years of age or incapable of self-support who was dependent on and received his chief support from the taxpayer.

2. Dependencies as "investment."

The dependents-as-consumption theory is occasionally buttressed by suggestions that the taxpayer's expenditures to support dependents, especially minor children, are investments whose payoff will come in the future if the taxpayer needs financial aid from his erstwhile beneficiaries. So viewed, the cost of supporting dependents should no more be deductible than premiums paid for insurance against personal calamities or amounts invested in marketable securities.

I know of no attempt to pursue the dependents-as-investment theory

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155. H. Simons, supra note 99, at 137-41, passim. In these passages, Simons wanders back and forth between income and death taxation, but I take the quoted comments to relate to income taxation.

156. See also H. Simons, Federal Tax Reform 54 (1950) (proposing a $250 exemption for dependents "after the war," i.e., World War II).

157. A dependency deduction was denied in Hamilton v. Commissioner, 34 T.C. 927 (1960), to a taxpayer whose support of the alleged dependent was intended as compensation for present or future housekeeping services rather than motivated by affection, charity or like impulses. However appropriate this restriction might be in applying § 152(a)(9), see note 175 infra, it has not been thought applicable to run-of-the-mill dependency claims for children, even if they wash dishes and mow the lawn. See also note 107 supra and accompanying text.
rigorously, or to explore its implicit corollary that the taxpayer would be entitled to a belated deduction if his children are unable or refuse to support him in his hour of need. (Did King Lear incur a deductible loss from abandonment or embezzlement?) For the peasant in Bangladesh, children may be an informal social security system; they are often regarded as “the poor man’s capital” in the folklore of poverty. But the concept has made little headway in the analysis of our society, and tax theorists, probably fearing its exotic or even faintly comic overtones, have used it only as a makeweight argument when debating the propriety of tax allowances for dependents. If the current vogue for economic theories of familial and other interpersonal relationships grows, however, the dependents-as-investment rationale may yet come to rival the dependents-as-consumption rationale.

3. Dependents as reducing taxpaying capacity.

In sharp contrast to the theory that the support of dependents is a form of personal consumption that the tax law should disregard is the theory that taxpaying capacity depends on the number of mouths that the taxpayer feels legally or morally obligated to feed. Like marriage to a non-employed spouse, parenthood costs money; indeed, it is more costly, since infants consume rather than supply unpaid household services, thus absorbing time and energy that the parents might otherwise have devoted to activities benefitting only themselves. To be sure, nobody forced the taxpayer to procreate, but this does not mean that the cost of supporting children is no more entitled to legal recognition than the cost of maintaining a yacht. For one thing, the decision to have children is irreversible; they cannot be abandoned, like a hobby that has become burdensome or boring. Moreover, society feels an obligation to support the children—but not the hobby—if the taxpayer is unable to do so. No one but a tax theorist, it might be asserted, could fail to see the difference. For these reasons, it is argued, the taxpayer’s taxpaying capacity is reduced by parenthood (and, in most circumstances, by the support of other dependents) to a degree that should be reflected in his tax liability.

Another response to the dependents-as-consumption theory is that amounts spent for the support of dependents are consumed by the dependent, not by the person providing the support, and should therefore be taxed to the former. To the extent of their legal obligation to support their children (and perhaps even beyond that limit), parents can be appropriately likened to conduits, whose receipts should be taxed not to them but to those who receive the food, clothing, and shelter for which the funds

are expended. In short, the ultimate tax issue in this area is not whether income has been received, but to whom an agreed amount of income should be taxed.159


I should perhaps take note here of another set of attitudes toward the dependency exemption, concerned with its relation to population policy. If a rising birth rate is a Good Thing for the nation, generous dependency allowances may seem appropriate, but if a reduction in the birth rate is the desired national objective, dependency allowances may be criticized as counterproductive, like a subsidy for polluting the environment with non-returnable bottles.160 While neither side of this argument can offer any statistical evidence of the effect of tax allowances on the national birth rate, I doubt that even the most computerized econometrician weighs the value of a dependency exemption before procreation. Perhaps the dependency allowance, at least for children, is more important as a symbol of national policy than as an influence on the birth rate. If so, denial of the deduction for a year or two after the birth of an “excess” child may be symbol enough, and if the allowance might thereafter be restored to the antisocial parents in order to measure their taxpaying capacity more adequately. After all, even convicted criminals get some of their civil rights back after they have paid their debt to society.

C. Alternative Types of Dependency Allowances

If accepted, the theory that dependents reduce the taxpaying capacity of their patrons can be translated into any of a number of statutory forms. One approach, which came close to winning Henry Simons’ endorsement despite his professed adherence to the dependents-as-consumption theory, is to allow the taxpayer to deduct expenditures for the support of dependents (as though the income on receipt were subject to an obligation to share it with others) and to require the dependents to include the same amount on their personal tax returns.161 This remedy resembles the income

159. See note 100 supra and accompanying text.

160. A third approach, neutrality, is based on the ground that the government should not intervene in a matter so personal as procreation. Whether neutrality is achieved by granting, or by denying, dependency allowances depends on whether taxpaying capacity is best measured with, or without, such allowances. Neutrality, therefore, is a destination, not a guidepost. See generally Schaffer & Berman, Tax Exemptions and the Birthrate: The Singleminded Approach to Public Policy, 3 Environ. Aff. 687 (1974).

161. After discussing this approach, Simons says that “[s]ome concessions of this sort seem necessary to equitable relative taxation of persons with similar earnings and different family obligations.” H. Simons, supra note 99, at 138–39. If I read him correctly, he ultimately rejects this idea not as a matter of principle, but primarily because “compensating rate differences” (to recoup the lost revenue and restore some unspecified degree of progression) are not likely to be enacted—a political judgment that, of course, would vary with time. See also note 100 supra.
splitting sanctioned by pre-1948 law for married couples in community property states, which similarly reflected the divided interests in their joint income by permitting it to be divided between them for tax purposes.\textsuperscript{162} It also resembles the current statutory treatment of alimony, which is both deductible by the spouse who makes the payments\textsuperscript{163} and taxable to the recipient.\textsuperscript{164}

A statutory deduction for expenditures on dependents, conditioned on inclusion of the same amount in the dependent's taxable income, would be difficult to administer if it required measurements of the amount actually spent for the support of each dependent. Amounts paid or earmarked for the dependent's clothing, medical expenses, education and other individual needs might be accurately determined, at least by taxpayers with a talent for domestic bookkeeping, but general household expenses would have to be allocated on a fractional or other basis between the taxpayer and his dependents. A cruder but more feasible way of splitting income between the taxpayer and his dependents would be the allocation of a prescribed fraction of the taxpayer's income (e.g., 10 percent) to each dependent. This fractional share would be excluded from the taxpayer's income as though he were a mere conduit and taxed to the dependent.

A more conventional statutory response to the reduced taxpaying capacity attributable to the taxpayer's support of dependents is a deduction or credit, without any compensating requirement that the dependent report this amount as income. The allowance could vary with the taxpayer's income, or with the actual or estimated amount of support provided by him, but Congress has consistently fixed the allowance at a flat amount, regardless of the taxpayer's income, ever since it first authorized a dependency exemption in 1917.

Being a flat deduction, the dependency allowance increases in value as the taxpayer's income and hence his marginal tax rate rises, but it is not otherwise related to the level of the taxpayer's income or his expenditures for the support of his dependents. If the function of the allowance is to take account of the actual cost of supporting children, it does not perform very well. To be sure, it may pass muster at the bottom of the income ladder, where it is augmented by the low-income allowance. A childless couple pays no tax unless their income exceeds $2,800, which is almost identical with the amount needed for a poverty-level budget.\textsuperscript{165} With two children, they can receive another $1,500 without tax, and this exempt amount is very close to the estimated cost of supporting the children at the same sub-

\textsuperscript{163} § 71.
\textsuperscript{164} § 215.
\textsuperscript{165} See 1972 House Hearings, supra note 10, at 81, chart 2 (statement of Hon. Edwin S. Cohen).
sistence level. However, at higher—but by no means jet-set levels—the flat allowance of $750 per child is rapidly outpaced by the actual cost of supporting children, and provides only token differentiation between childless couples and families at middle- and upper-income levels. Indeed, a uniform allowance is bound to be wrong most of the time; it is worse than a broken clock, which is right once every twelve hours.

Even so, a uniform allowance might be tolerated for families in the stratosphere (e.g., above $100,000). I have argued earlier that efforts to relate tax liabilities to differences in the relative cost of living for single persons and married couples of equal income becomes difficult if the persons being compared are extremely rich. In deciding how much difference there should be between the tax liability of a childless couple with $200,000 of income and that of a couple with the same income and two minor children, one must similarly resort to socio-economic criteria as vague as those that underlie judgments about the degree of progression in the rate schedule. When the comparison is between childless couples and larger family units at more modest income levels, however, the grounds for decision become somewhat more solid, although interpersonal comparisons always embody an unavoidable residue of fiat. For those who believe that the tax burden should reflect the actual cost of supporting dependents at the family's income level, rather than at a mere subsistence level, the ultimate issue is whether an allowance that rises with income would accomplish this objective better than a flat allowance. The formula for a rising allowance will, in the end, be arbitrary, but it will almost certainly be less so than a uniform allowance.

Although the $750 dependency deduction of existing law makes no effort to measure the actual cost of supporting children at varying income levels, its value rises with the taxpayer's marginal tax rate. At the bottom of the income ladder, an exemption is worth $105 (i.e., 14 percent of $750), or less if the couple's income is so low that they cannot "use" the deduction in full; at the top, it saves them $525 (i.e., 70 percent of $750). This increase in the exemption's value, although it does not keep pace with the escalating cost of supporting children as family income rises, has been stigmatized as "regressive" by many critics, and they have proposed the substitution of either a deduction that declines in amount with income or a credit of a fixed amount against the taxpayer's tax liability. A credit would be a less

166. See notes 103-05 supra and accompanying text.
167. These proposals are discussed in Brannon & Mores, The Tax Allowance for Dependents: Deductions versus Credits, 26 NAT'L TAx J. 599 (1973).

A declining (or "vanishing") exemption would be reduced according to a formula related to the taxpayer's income. For example, if the $750 dependency exemption of current law were reduced by one dollar for each three dollars of adjusted gross income above $10,000, the allowance would decline as follows: $10,000 (or below) AGI: $750 exemption; $10,750 AGI: $500 exemption; $11,500 AGI: $250 exemption; $12,250 (or above) AGI: $0 exemption.
drastic remedy than a vanishing exemption, since it would be granted to all taxpayers, regardless of income. If "refundable" (i.e., payable to the taxpayer in cash if and to the extent it exceeded his tax liability), it would benefit nontaxpayers as well as those with a positive tax liability.

Although both of these substitutes for the deduction of existing law would increase the progressivity of the tax structure, this result would be accomplished by imposing, at moderate and upper income levels, identical (or, in the case of a modest credit, substantially identical) tax burdens on families of disparate sizes. This choice between progression and differentiation by family size, however, is not an unavoidable dilemma (as often implied by commentators), but a false dichotomy. In fact, any desired degree of progression is entirely compatible with tax burdens that vary with family size.

Progression is primarily a question of "vertical" equity—should there be a difference in tax liability between two otherwise comparable taxpayers with different amounts of income?—while dependency allowances raise a question of "horizontal" equity—should there be a difference between a taxpayer with dependents and one with the same amount of income but no dependents? Proponents of progression will answer the first question with a resounding "yes," but with complete consistency can answer the second question with either a "yes" or a "no." Conversely, opponents of progression will answer "no" to the first question, but may respond with either a "yes" or a "no" to the second. Whether the rate schedule is steep or gentle, it is entirely feasible to distinguish taxpayers at any given income by reference to family size. Another way of putting the same point is that the revenue cost of any dependency allowance can be recouped by increasing the average tax rate on all taxpayers at the income level "responsible" for the revenue loss.

Of course, a necessary result of any dependency allowance is that a taxpayer with dependents will pay less tax than some unencumbered taxpayers with less income; the more generous the allowance, the more pronounced will be this phenomenon. But if taxing capacity is reduced by family responsibilities, this phenomenon should be welcomed, not criticized.

168. A per capita division (i.e., among parents, children, and grandchildren) at low and middle income levels, with each member of the family being taxed on his or her aliquot share, was recommended by Sidney Webb in a Fabian Society tract criticizing the British income tax from a socialist perspective. Webb coupled this proposal with a recommendation for greater progression, and thus obviously saw no conflict between the two. Webb, supra note 56, at 236-47.

Alfred Pigou put the point succinctly when he wrote that differentiation for family size at high income levels "is not a question of giving rich people privileges as compared with poor people, but of adjusting the burden fairly within each income class between people whose situations are different." A. PIGOU, The Report of the Royal Commission on the Income Tax, in ESSAYS IN APPLIED ECONOMICS 126, 134 (1924).
In this connection, it is worth recalling that the “demogrant” plan sponsored by Senator George McGovern during the 1972 presidential election campaign was part of a broad tax reform proposal that would have eliminated virtually all of the personal deductions and exemptions of existing tax law while retaining family size as a basis for differentiating the tax burden. Indeed, under the McGovern plan, family size was a far more important determinant of tax liability than it is under existing law. Thus, the current difference in tax liability at the $2,000 taxable income level between a childless couple and a couple with three children is $720 under existing law, but it would have risen to $3,000 under the McGovern proposal, and even at higher levels there would have been dramatic increases in the tax effect of family size. The McGovern plan did not lack critics, but I do not recall any suggestion that the expanded role played by family size in differentiating the tax burden was inconsistent with a commitment to progression. Moreover, even the most progressive rate schedule should be applied to the “right” taxpayer, and if the dependent rather than the parent is the appropriate person to be taxed on amounts spent for his or her support (the “conduit” theory outlined above), both the McGovern plan and the dependency exemption of existing law seriously overtax the parent and can therefore be described as cases of progression run amuck.

D. Statutory Rules

As pointed out earlier, the dependency exemption entered the tax law in 1917 as an allowance for dependent children under the age of 18 or incapable of self-support by virtue of mental or physical disability. The allowance was expanded in 1918 to embrace any person who was “dependent upon and receiving his chief support from the taxpayer,” if under 18 or incapable of self-support, and it remained in this form until 1944. During this period, a relationship of blood, marriage, or adoption between the dependent and the taxpayer was not necessary, and the language “dependent upon . . . the taxpayer” was interpreted to include voluntary support, rather than restricted to obligations imposed on the taxpayer by law.

Without explaining why the existing definition of “dependent” was not satisfactory, in 1944 the House Committee on Ways and Means recommended and Congress enacted amendments (a) requiring the dependent to be related to the taxpayer by blood (within a specified degree of proximity), marriage, or adoption, (b) eliminating the requirement that the dependent be under 18 or incapable of self-support, and (c) disqualifying

dependents with gross income of $500 or more. The qualifying relationships prescribed in 1944, to which only a few minor categories have been added in later years, were: children and their descendents, stepchildren, parents and their ancestors, siblings, stepparents and stepsiblings, siblings by the half blood, aunts and uncles, nieces and nephews, sons- and daughters-in-law, parents-in-law, and brothers- and sisters-in-law. No reason was given by Congress for requiring that one of these relationships (or marriage or adoption) exist between the taxpayer and the dependent. It may have been thought that the support of distant relatives and other persons is capriciously personal generosity, and that the taxpayer should be encouraged instead to contribute to charitable organizations that have a fiduciary obligation to compare the needs of all applicants for assistance and to prefer those who are most "deserving" when tested by generalized standards. But if critics of our national life are correct in discerning a revulsion against anonymity and bureaucracy and a yearning for spontaneity, perhaps anyone whom the taxpayer chooses to support should be treated as a "dependent," even if the choice is idiosyncratic.

Once it was decided, for whatever reason, to restrict the dependency exemption to persons related to the taxpayer, the line between "close" and "remote" relationships was bound to be arbitrary and to result in excluding some persons despite their intimate emotional ties to the taxpayer. A determined taxpayer, however, can bring such a person into the charmed circle by availing himself of section 152(a)(9), enacted in 1954, which permits persons residing with the taxpayer as members of his household to qualify, unless the relationship is illicit. Another way to establish a qualifying relationship is to adopt the dependent. The possibility of using this procedure with war orphans, whose support in some foreign countries might cost less than the tax benefit of claiming them as dependents, accounts for the enactment in 1944 of section 152(b)(3), disqualifying alien dependents, unless resident in the United States or an adjacent country.

In addition to requiring that the dependent be linked to the taxpayer by blood, marriage or adoption, the 1944 legislation provided that persons with gross income of $500 (now $750) or more could not be claimed as dependents, regardless of the amount spent by the taxpayer for their sup-

172. See Havemeyer v. Commissioner, 98 F.2d 706 (2d Cir. 1938) (allowing charitable deduction for gift to association, although taxpayer was on Board of Directors and "relief" was always given to friends of Board members). See also Morrell v. Commissioner, 107 F.2d 34 (3d Cir. 1939) (taxpayer preferred a dependency allowance rather than a charitable contribution deduction, although usually the opposite would be the case).
173. Section 152(b)(5), which excludes illicit dependents, was enacted in 1958 to provide statutory support for a conclusion already reached by judicial construction of § 152(a)(9) in Turnipseed v. Commissioner, 27 T.C. 758 (1957).
174. Section 152(b)(3) is somewhat broader than its objective required, since it disqualifies blood relatives as well as adopted dependents. It is also subject to two minor exceptions.
port. This limitation was presumably intended to disqualify persons who were not in need of financial assistance.

Viewed in this light, the "gross income" requirement of existing law is at once too lenient and too severe. It is too lenient because it disregards receipts and benefits that are excluded from the dependent's "gross income" as defined by the Code, such as the value of owner-occupied residences, gifts and bequests, state and municipal bond interest, scholarships, and life insurance proceeds. Whatever may be the validity of the reasons for excluding these items from gross income in computing tax liability, there is no reason in theory to disregard them in determining whether a dependent is truly in need of the taxpayer's financial assistance. At the level of practice, however, the use of a single standard in measuring "gross income" is administratively convenient. It also mitigates—though only in a rough and haphazard way—the fact that $750 is insufficient to finance self-support except at the poverty level and, even then, only for persons living in a family unit large enough to profit from economies of scale.

At the same time that the dependent's "gross income" is too lenient, it is also too severe a yardstick. This is because the dependent's economic income may be less than his or her statutory gross income, by reason of business expenses and losses, which are deducted from gross income (in computing adjusted gross income) rather than in computing gross income itself. Thus, if the taxpayer's mother receives $800 of gross rental income, she may not be claimed as a dependent even if taxes, interest, and repairs on the rental property resulted in an out-of-pocket loss.

Finally, the provision has an irrational all-or-nothing quality: a single dollar of "excess" gross income received by the dependent can result in a loss to the taxpayer of an exemption worth as much as $525 (i.e., 70 percent of $750). These anomalies were alleviated in 1954, when the gross income limit was made inapplicable to any dependent child of the taxpayer who is under the age of 19 or a full-time student. The stated reasons were that the restriction was a "hardship to parents who provide most of the support for their children, although the latter earns slightly over $600 [the dollar limit in 1954]," and that it put unjustified pressure on the child to stop work just before earnings reached the statutory limit. No explanation was given for

175. However, the use of these receipts by the dependent is taken into account in determining under § 152(a) whether the taxpayer provided more than one-half of the dependent's support, except for certain scholarships, which are disregarded for this purpose by virtue of § 152(d).

176. See notes 101-05 supra and accompanying text.


not extending the same relief to other dependents; possibly it was thought that the problem arose primarily from college students' summer employment.

The 1954 change has given rise to a new complaint, viz., that a student with earnings in excess of $750 can take a personal exemption of $750 on his own return at the same time that his parents are deducting a dependency exemption of $750 on their return if they provided more than half of his support. This "doubling up" of exemptions was not, in fact, a new phenomenon, since all dependents with income were—and still are—entitled to their own personal exemptions, regardless of the dependency exemptions claimed on their behalf by the taxpayers who support them. Assume, for example, that a parent supplies more than half of the support of two 20-year old children, a student with $751 of gross income, and a nonstudent with $749 of gross income. Under existing law, the parent will be entitled to two dependency exemptions, only the first of which has been singled out for the "doubling up" criticism described above. I have suggested earlier that the dependency allowance is already too meager, and this argues against further restrictions, but if limits are to be imposed, they should be consistently applied to all dependents.

IV. TRANSACTIONS WITHIN THE FAMILY

A. Sales of Property

If one spouse sells property to another, any gain must be taken into account in computing the seller's income, even if they file a joint return.179

179. The exemption was $600 (rather than $750) from 1954 to 1970. It should be noted that the "double exemption" will be less significant for the student than the low income allowance, which allows any taxpayer to earn $1300 before having to pay any tax. Thus, the combination of personal exemption and low income allowance allows the student to earn $2050 without paying any tax while his parents continue to take a $750 dependency deduction. When claimed as a dependent, the student's percentage standard deduction or low income allowance is computed by reference to earned income only, by virtue of § 141(c), enacted in 1971. However, no matter how large an otherwise qualified child's income may be, the parents may claim a dependency allowance if they provide more than half of the amount actually used for the child's support. Thus, if a wealthy child saves his or her own income, or uses it for nonsupport purposes, the indulgent parent's dependency allowance is not jeopardized. See Treas. Reg. § 1.152-1 (a)(2)(i) (1971).

The "double exemption" has been criticized as being inequitable and overly generous. For example, it is the only dependency exemption designated as a tax expenditure in the fiscal 1976 Tax Expenditure Budget. See Office of Management and Budget, supra note 154, at 108-09. As Seltzer has pointed out, however, alternative arrangements also present serious problems. L. Seltzer, supra note 153, at 7-8. For example, when the taxpayer is required to add the dependent to his own return (or when the individual is not qualified as a dependent because he earns over $750), the dependent's income (or money used to support him) is subjected to a high marginal rate and there is an implication that the taxpayer has control over the dependent's income. The first of these seems unfair; the second is untrue in most situations.

180. Such sales may be subject to less favorable treatment than sales to outsiders. See, e.g., Lieb v. Commissioner, 40 T.C. 161, 164 (1963) (bond amortization deductions denied to husband and wife where purported sale between them appeared to be sham); § 1239 (capital gain treatment denied on certain sales of depreciable property to related taxpayers).
This adherence to individualism contrasts sharply with the widely espoused theory that husband and wife constitute a single economic entity. Perhaps spouses are required to report gain on selling property to each other on the ground that the sale is evidence that in fact they do not view themselves as a single economic entity; otherwise, it might be argued, the property would have been transferred by gift rather than by sale. Whatever the source of the rule—which may, of course, stem more from legislative indifference than legislative concern—it contrasts with the privilege accorded to affiliated corporations to file consolidated returns that disregard internal transactions and reflect income only when the group deals with outsiders. Married couples are not granted a similar privilege.

Though gain on a sale of property by one spouse to another is taxed, losses incurred on such sales cannot be deducted. This restriction, enacted in 1943 and now embodied in section 267(a)(1), applies not only to sales to the taxpayer's spouse, but also to sales to ancestors, lineal descendents, and siblings. Even before section 267's enactment, losses on an intrafamily sale could be disallowed if the government could prove that the seller did not actually give up control or sold at an artificially low price; section 267(a)(1) dispenses with an inquiry into such circumstances, which are often peculiarly within the knowledge of the taxpayer, and disallows the loss even if the transaction was executed in good faith and at fair market value. Thus, section 267 has been interpreted by the Supreme Court to disallow a loss on stock sold by one spouse because the other spouse simultaneously purchased the same number of shares of the same corporation, even though both sales were effected through brokers on the New York Stock Exchange at the prevailing market prices. In its opinion, the Court had this to say about the underlying presupposition of section 267: "The one common characteristic of these groups [i.e., the family relationships specified by section 267(a)(1)] is that their members, although distinct legal entities, generally have a near-identity of economic interests."

Sales by one spouse to another are taxed not by virtue of an affirmative special rule, but rather because they do not fit within any statutory exception to the general rule of § 1002 (gain on sales or exchanges of property recognized unless otherwise provided).

For the record, it may be worth listing several related problems in the family solidarity area: Whiting v. Dow Chemical Co., 386 F. Supp. 1130 (S.D.N.Y. 1974) (husband and wife must be taken as a unit in applying "insider" liability provision of Securities Exchange Act of 1934; requiring a showing that one spouse was alter ego of the other would undermine effectiveness of statute); Wall Street...
As we have seen, this premise of "a near-identity of economic interests" within the family underlies the numerous proposals for the aggregation of family income in computing the group's annual tax liability that have been advanced by tax theorists. But these proposals, unlike section 267, have invariably been confined to parents and minor children, excluding adult children and, a fortiori, more distant relatives, such as grandparents, grandchildren, and siblings. Moreover, no proposal for compulsory family income aggregation—not even between husband and wife—has ever been accepted by Congress. Yet the far more sweeping concept of family solidarity that is embodied in section 267 not only has survived without criticism, but has become the model for a plethora of other restrictions on intrafamily transactions involving property.

Section 267(a)(1) applies to "sales or exchanges of property," but not to the manifold other transactions of a business or investment character between members of a family that may give rise to deductions, such as the payment of salaries, rent, or interest. In general, the individuality of each member of a family is respected in passing on the validity of such transactions: parents may deduct compensation paid to children for working in the family business; interest paid on an intrafamily loan may be deducted by the borrower; and a tenant may deduct rent paid for the use of property leased by him from a member of his family. If the deduction reduces the tax liability of the payor more than it increases the liability of the recipient, however, the courts scrutinize the underlying transaction closely, demanding proof that its terms are equivalent to an arm's length bargain and that it serves a purpose other than tax avoidance. Whether the language of "presumption" is used or not, their working hypothesis is that transactions with outsiders have a built-in guarantee of good faith and business purpose, but that intrafamily transactions are less likely to be what they purport to be. The ultimate source of this doubt is, of course, a judicial view of social behavior, not an explicit statutory direction to the courts.

185. Congressional refusal to consolidate the income of minor children reached its zenith in the enactment of § 73. See note 78 supra.

186. E.g., § 1235 (allowing certain patent royalties to be reported as capital gain rather than ordinary income, provided the transferee of the patent is not a member of the taxpayer's family); § 1237 (allowing gain on certain sales of subdivided real property to be reported as capital gain rather than ordinary income unless substantial improvements were made by the taxpayer or members of his family; § 1239, see note 180 supra.
B. Attribution Rules

Skepticism about intrafamily transactions has been carried to the highest level of exquisite intricacy by the Code’s numerous stock attribution rules, which, in prescribing the tax treatment of a wide range of corporate events, require taxpayers to be treated as constructive owners of stock that is actually owned by members of their families. Based on the premise that the family is a single economic unit, the attribution rules can result in decreasing or disallowing deductions, converting capital gains into ordinary income, requiring otherwise unrecognized gains to be recognized, denying a preferred tax status, and other adverse changes in tax allowances. In 1967, it was reported that the attribution rules could apply to 34 different substantive situations (an estimate that almost certainly would have to be increased today), including such diverse areas as stock redemptions, corporate liquidations, corporate surtax exemptions, personal holding companies, controlled foreign corporations, stock options, net operating loss carryovers, and private foundations.

In addition to formal attribution rules, the Code contains many other provisions that saddle taxpayers with the financial interests, status, or transactions of their relatives. Thus, a taxpayer may be taxed more heavily if his wife is a trustee or beneficiary of a trust established by him, if he becomes a director or officer of a corporation in which a parent owns stock, or if he sells a partnership interest to a child rather than to a more distant relative or unrelated person. Sometimes these family solidarity rules penalize an organization rather than (or as well as) the individuals. Thus, a foundation may become subject to the rigorous “private foundation” rules if a trustee is related to a substantial contributor, and a corporation becomes a personal holding company if a specified amount of its stock is held by a limited number of family groups. In situations of this type, the interests

187. Stock owned by trusts, partnerships and corporations is also attributed to the beneficial owners under the statutory rules because of their financial stake in the entity holding the stock. The discussion in this Article is not concerned with these “beneficial ownership” rules, but only with attribution from one member of a family to another, where the premise of family solidarity may, or may not, accord with the facts. Where there is “chain” attribution (e.g., from a trust to a beneficiary, and then from the beneficiary to a member of his or her family), my concern is only with the second link in the chain.


189. See Goldstein, Bringing the Attribution Rules into Sharper Focus: How and Where They Apply, supra note 188; Ricketts, supra note 188.

190. See §§ 674(d); 677(b); 302(c); 704(e). See also § 1313(c).

191. See §§ 509 & 496 (private foundation); §§ 542(a) & 544(a)(2) (personal holding company). See also §§ 552(a) & 554(a)(2) (foreign personal holding company); §§ 957–58 (controlled foreign corporation).
of innocent bystanders may be seriously damaged by the intrafamily relationships of complete strangers whose genealogy is unknown to them.\footnote{192}

The attribution and family solidarity rules are replete with fine distinctions, especially in their treatment of the taxpayer’s adult children, siblings, brothers- and sisters-in-law, and grandparents, who are all treated as part of the taxpayer’s economic family by some rules and excluded from it by others. The only common denominator of these complex rules is their consistent inclusion of the taxpayer’s spouse in the charmed (or tainted) circle,\footnote{193} but even this is subject to qualification (e.g., sections 672(c)(1) and 674(d) distinguish between a spouse who lives with, and one who lives apart from, the grantor of a trust). In theory, the transactions subject to attribution and family solidarity rules could be classified, and carefully drafted definitions of “family” could then be assigned to the underlying transactions in proportion to their sensitivity to family influence. Thus, in passing on the least sensitive category of transactions, taxpayers would be charged solely with stock owned by their spouses, the next level of sensitivity would take account of stock owned by minor children and the spouse, and so on, until the end of the attribution chain (aunts and uncles? second cousins once removed?) was reached.

In actuality, it is impossible to fit the punishment so neatly to the crime. The only basis for deciding when attribution should be imposed and when the taxpayer should instead be treated as an independent entity is intuition, and its insights are exhausted when this original judgment is made. If the divergent definitions of “family” found in existing law were shuffled and reassigned at random to the operative provisions of the Code, I doubt that anyone could offer sound reasons for restoring the status quo ante rather than retaining the new assignments. In the same vein, I would suggest that selecting one set of existing statutory rules by a throw of dice, and abandoning the other rules, would be no more arbitrary than existing law, which contains a set of seemingly tailor-made rules for each substantive situation.

C. Escape Hatches

A few of the Code’s attribution and family solidarity rules contain escape hatches. Under section 302(c)(2), for example, a taxpayer whose stock has been redeemed is liberated from the family attribution rules...
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(which, if applicable, would deny capital gain treatment to any gain on the redemption), if he refrains from becoming an officer or director of the corporation, if none of the redeemed stock was acquired from a related person, as defined in section 318(a), during the previous 10-year period, and if certain other conditions are satisfied. Another example is section 672(c), which permits the statutory presumption that certain persons are "subservient" to the grantor of a trust to be rebutted by a preponderance of the evidence. But most statutory rules do not acknowledge that families are sometimes dens of hostility rather than lovenests. Thus, stock owned by one spouse is usually attributed to the other spouse despite estrangement or desertion; often only a legal decree of divorce or separation can cut the chain. As for blood relationships, they are even more permanent ties than marriage. (An embryo A. P. Herbert might try his hand at "The Attribution Murder Case," turning on whether public policy would be violated by allowing Cain to escape attribution from Abel by fratricide.) Even if Freud himself would be shocked by the reciprocal hatred of persons locked together by the statutory attribution rules, they seem impervious to the intrusion of realism, save for the rare statutory provision that can be interpreted to permit a judicial exemption.

Indeed, their irrebuttable nature is about the only characteristic of the statutory attribution rules to escape criticism. It has instead elicited unqualified praise from the leading commentators:

"These rules of constructive ownership rest on certain assumptions which are readily supported in the everyday conduct of affairs... A husband can be regarded as "owning" his wife's stock. Tax administration would be severely handicapped if the rules applied only as presumptions; tax planning, moreover, would be hazardous if it depended on an analysis of the actual relationship in each case."

The assertion that rebuttable constructive ownership rules would make tax planning "hazardous" cannot be accepted without qualification. Since the attribution rules of existing law almost always operate to the taxpayer's

194. See also § 1563(c)(5) (waiving attribution from a spouse—in restricting corporate surtax exemptions—if the attributee is not a director, employee, or participant in management).

195. See, e.g., the court's reference, no doubt based on long experience, to "another internecine struggle over a valuable family estate" in Vincent v. Moench, 473 F.2d 430, 431 (10th Cir. 1973).

The statutory rules are confined to family relationships and do not apply to informal alliances—not even to a commune whose organizing principle is the primacy of love and trust among its members.

196. For rare exceptions to this custom, see §§ 672(c)(1) and 674(d), which distinguish between a spouse who lives with the grantor of a trust and one who does not. See also § 143(b)(3) (person not considered as married if spouse "is not a member of [former's] household").

197. See Haft Trust v. Commissioner, 510 F.2d 43 (1st Cir. 1975) (holding that attribution between spouses in applying § 301(b)(1)—redemption not essentially equivalent to dividend—is not required in case of family hostility and discord and rejecting the administrative advantages of "wooden subjugation" to the attribution rules).

disadvantage, they are not "safe harbor" charts. If they were made rebuttable, taxpayers who desired certainty could continue to avoid transactions evoking attribution, but those who were convinced of their ability to rebut the presumption could take their chances. For them, the irrebuttable presumptions of existing law provide "protection" that they would like to relinquish.

The assertion that "[t]ax administration would be severely handicapped" if attribution were rebuttable is more persuasive, but it overstates the danger, which could be minimized by waiving attribution only if the taxpayer clearly proved its unfairness and negated any tax avoidance aroma. If more safeguards are thought necessary, the privilege could be limited to stock owned by the taxpayer's siblings, parents, and adult children, to stock acquired by purchase rather than by gift, and to stock held for a substantial period of time. As pointed out earlier, existing law already contains a few escape hatches that are subject to similar limitations. Another possibility is to authorize the Treasury to waive the family attribution rules when it is satisfied that tax avoidance will not result.

Lacking, as they do, any mechanism to relieve the taxpayer of attribution from relatives who are clearly independent or hostile, it is surprising that the attribution rules have not been subjected to more political and even constitutional attack. Legislation denying privileges, or imposing responsibilities because of the behavior or status of a citizen's relatives may not be as "suspect" as discrimination based on race or sex, but it ordinarily raises civil libertarian and, increasingly, judicial hackles. As of now, the Internal Revenue Code leads the whole corpus juris in imposing disabilities by virtue of one's family relationships. Customarily praised for its realism, this practice may come to be seen as imputing guilt by association. It is hardly necessary to document the growing antipathy to such rules of law.
or to develop at length the prediction that the Code will not forever remain a walled enclave, immune to the winds of change.

V. Conclusion

During a 1963 discussion at the Brookings Institution of a forthcoming book on federal taxation of the family, a participant commented: “I don’t think that 27 economists should have been assembled to address themselves to problems which are really partly anthropological, partly sociological, partly anything except what we have competence in.” In point of fact, some of the “27 economists” at the Brookings convocation were lawyers, but their expertise in matters anthropological and sociological was probably not enhanced by either their legal training or their innocence of economics. No doubt a squad of anthropologists and sociologists could have added some insights to the melange of views expressed at the meeting, but definitive answers to the issues under discussion could not have come from any corner of the behavioral sciences.

If my extended essay has a unifying theme, it is that theoreticians, whatever their backgrounds, cannot “solve” the problem of taxing family income. They can identify the issues that must be resolved, point out conflicts among the objectives to be served, propose alternative approaches, and predict the outcome of picking one route rather than another. Having performed these functions, the expert must give way to the citizen, whose judgments in the end can rest on nothing more precise or permanent than collective social preferences. Once the citizenry casts the die, however, the expert is entitled to offer a postscript, namely, that the chosen solution will itself turn out, sooner or later, to be a problem.

Santayana once credited an unnamed “accomplished mathematician” with the observation that “all problems are divided into two classes, soluble questions, which are trivial, and important questions, which are insoluble.” To mathematicians and philosophers, searching for great truths \textit{sub specie aeternitatis}, the questions canvassed in my Essay no doubt seem trivial. But a close reading of the epigram reveals that it leaves open the possibility that some trivial questions are insoluble. In this respect, if in no other, the taxation of family income resembles the weighty aesthetic problems that reminded Santayana of the soluble-insoluble dichotomy.


205. H. Groves, \textit{supra} note 1, at 93 n.1. \textit{See also} note 146 \textit{supra}. For a less diffident view of the scope of economics, \textit{see} note 158 \textit{supra}.
