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The Marriage Tax Revisited: An Analysis of the Tax Consequences of Marriage

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THE MARRIAGE TAX REVISITED: AN ANALYSIS OF THE TAX CONSEQUENCES OF MARRIAGE

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"[I]t is better to marry than to burn,"[1] advises a widely read Authority. The implication is that marrying and burning are mutually exclusive. They are not. In the tax area, among other areas, married folk often get burned.

The reason is that matrimony can lead to the "marriage tax."[2] This "tax" comes into play upon the union of two single persons with roughly the same level of income. An illustration is in order. Consider two taxpayers each with taxable income of $25,000.[3] In 1988 their total tax if they are both singles comes to $9,360. If they are married, by contrast, the tax amounts to $10,133. The extra or incremental cost to the taxpayer resulting from marriage is the marriage tax, in this case $773.[4]

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1. 1 *Corinthians* 7:9.

2. Discussion of the marriage tax has often suffered from a certain imprecision of language. The word "income" has been used too frequently without elaboration as to whether it is taxable, adjusted gross or simply gross income that is being referred to.

3. It is probably more useful to define the marriage tax as the difference in tax liability resulting from the standard deduction as well as the rates. This is because the standard deduction in effect applies to all taxpayers and thus is really part of the rate structure. In 1988 the standard deduction for singles is $3,000, while for couples it is $5,000. In short, a two-earner couple that has the same gross income as two singles will have taxable income that is $1,000 higher. On the assumption that the parties in the hypothetical had equal *gross* income (and thus the taxable income is $51,000 for the couple and $25,000 for each of the singles) the marriage tax comes to $1,053.

4. In the 1970's, when the rate-based marriage penalty was frequently much higher than it is today, several cases were brought challenging the constitutionality of I.R.C. § 1 (which provides the rates for singles and marrieds). The taxpayers consistently lost. Mapes v. United States, 576 F.2d 896 (Ct. Cl. 1978), *cert. denied*, 439 U.S. 1046 (1978); Johnson v. United States, 422 F. Supp. 958 (N.D. Ind. 1976) *aff'd per curiam*, 550 F.2d 1239 (7th Cir. 1977), *cert. denied*, 434 U.S. 1012 (1978); Druker v. Commissioner, 697 F.2d 47 (2d Cir. 1982), *cert. denied*, 461 U.S. 957 (1983).

The marriage tax is, of course, the divorce bonus. To avoid the marriage tax, one couple in the mid-1970's divorced in December—marital status for filing purposes being determined at the end of the year—and remarried in January. The tax court signaled its unhappiness with that device in

One should not conclude that taxpayers marry only for poorer. Many couples find that marriage confers a significant tax benefit. To illustrate, if the wife in the previous example had taxable income of $50,000 and was the only money-maker in the family, her income tax based on her married status would be $10,133. If single, her tax would have been $11,680. The tax savings resulting from her married status comes to $1,547, which is the "marriage bonus."

There is a fairly substantial literature on the treatment of marriage by the tax system. A number of commentators — Professors Bittker, Gann, McIntyre and Oldman among them — have made significant contributions.[5] There are two important reasons, however, for yet another article. First, these articles were written against the backdrop of a far different Internal Revenue Code from that which exists today. Since 1975, when the first of these articles was written, tax rates have come down considerably (from 70% to 33% in the top bracket, for example), and the two-wage earner deduction has been enacted and repealed.[6] Moreover, although it is widely known that the marriage tax and bonus were not eliminated by the Tax Reform Act of 1986 (TRA 86), the extent to which those features have survived and changed under the Act is only now becoming apparent; and the economists who are providing data on the subject are already beginning to ask whether, under the new law, married couples are being treated fairly.

The second and principal reason for writing this article is that the marriage tax — *i.e.*, the marginal tax cost resulting from mar-

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Boyter v. Commissioner, 74 T.C. 989 (1980), *remanded*, 668 F.2d 1382 (4th Cir. 1981).

It should be pointed out that, except in unusual cases, far from solving the marriage tax problem, separate filing actually aggravates it. For one thing, the separate return rates (I.R.C. § 1(d)) are higher than those for singles (I.R.C. § 1(c)). Provisions of the tax law defining taxable income also discourage separate returns. For example, under I.R.C. § 86 social security receipts are taxed less favorably to separate filers than to singles. *See infra* note 7 and accompanying text.

5. *See* Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389 (1975); Brazer, *The Income Tax Treatment of the Family*, in THE ECONOMICS OF TAXATION (H. Aaron and M. Boskin, eds. 1980); Gann, *Abandoning Marital Status as a Factor in Allocating Income Tax Burdens*, 59 TEX. L. REV. 1 (1980); Gann, *The Earned Income Deduction: Congress's 1981 Response to the "Marriage Penalty" Tax*, 68 CORNELL L. REV. 468 (1983); McIntyre & Oldman, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 HARV. L. REV. 1573 (1977); O'Neil, *Family Issues in Taxation*, in TAXING THE FAMILY 1 (R. Penner ed. 1983) (*see also* responses to O'Neil by Minarik & Cohen, *Commentary*, in TAXING THE FAMILY 23).

6. *See infra* notes 10-11 and accompanying text.

riage — has been examined altogether too narrowly. There are numerous tax consequences of marriage that go well beyond the rate schedules. For example, under Internal Revenue Code § 86, a single individual must report up to one-half of his social security receipts as income if the total of that amount and his other income (including his tax exempt interest income) exceeds $25,000. Two married individuals who file a joint return will find that up to one-half of their social security receipts are taxable if their total income (similarly computed) exceeds $32,000. Thus two single taxpayers receiving social security payments will often find that their marriage increases their tax burden.[7]

Another illustration of the tax effect of marriage is the position of spouses under the estate and gift tax rules.[8] These provisions, which work in favor of married couples, allow spouses to pass to one another an unlimited amount of property free of transfer tax.

Thus this article — which consists of five parts — will update and expand the analysis of the marriage tax. The first part explores the existence and magnitude of the marriage tax and marriage bonus (narrowly defined)[9] under various income assumptions using 1988 rate schedules. The results are compared with those obtained under 1986 tax schedules. The second part summarizes the arguments for and against current law which often produces a marriage tax and bonus. It also sketches the history of the federal income tax in this area. The third part looks broadly at the tax consequences of marriage in the Internal Revenue Code. The fourth part examines the rationales underlying the relevant Code provisions. Finally, the fifth

7. An illustration will help here since the statute defies attempts to articulate the inclusion formula in a generally comprehensible manner. Let's take two unmarried taxpayers, each with social security receipts of $10,000, other income of $15,000, and $5,000 of tax-exempt income. None of their social security receipts would be taxable because, taking into account only one-half of the social security receipts, the total does not exceed the limit of $25,000. A married couple with each spouse in the same financial position, would be required to include $9,000 of social security receipts in their income because the $32,000 base amount has been exceeded. In this last case, if the taxpayers choose to file separately, reportable income from social security would be $10,000. This results from the fact that the base amount for separate filers is zero.

8. I.R.C. §§ 2056 & 2523 (1987).

9. That is, resulting only from application of the rate schedules and standard deduction tables. *See supra* notes 2 & 3.

part draws certain conclusions from the previous analysis and findings and makes a recommendation for a change in legislative policy. As will be seen, deciding whether ultimately the tax system discourages or encourages marriage can confound the most resolute researcher.

I.

The new tax rate schedules and standard deductions are shown in Tables 1 and 2. As Table 3 and Figures 1 to 6[10] demonstrate, the marriage tax (in the narrow sense) has survived TRA 86. This is true for virtually all levels of income where there is rough income equality between the spouses. Surprisingly, perhaps, at a number of income levels the marriage tax has actually increased somewhat. For upper income taxpayers, however, it has decreased and that decrease has been dramatic. The marriage bonus has generally increased under the new tax law.

The respective changes can be largely explained as resulting from: (1) the across-the-board reduction in rates which, in turn, has lowered the cost of adding a second source of income to the first; (2) the repeal of I.R.C. § 221, which allowed the two-wage earner deduction; and (3) the changes in the standard deduction and exemption amounts. Overall, it is estimated that in 1988 40% of United States couples will pay a marriage tax while 55% will receive a marriage bonus. The average tax and bonus are projected to be $1100 and $609, respectively.[11]

In sum, the marriage tax and bonus are still with us though the former has lost some of its potency. Because of the continued existence of the marriage tax, analysts are beginning to raise the old

10. Tables 1 and 3 are from G. Esenwein, Tax Reform Act of 1986 (H.R. 3838) Individual Income Tax Reform and Marriage Neutrality 5 (Congressional Research Service Document No. 86-6703).

Figures 1-6, are from H. Rosen, The Marriage Tax Is Down But Not Out (National Bureau of Economic Research Working Paper No. 2231, 1987). Rosen assumes use of the standard deduction. His assumption for unmarried couples is that the individual with higher earnings claims the two children as dependents and files as head of household while the other parent files as a single. Since Rosen's figures are based on wages, the data are not immediately comparable to the calculations at the outset of this article which were based on taxable income. *See supra* notes 2 & 3.

11. *See* H. Rosen, *supra* note 10, at 12.

questions about whether the marriage-related nonneutralities in the tax law warrant remedial action.[12] (No one, it might be observed, is complaining about the marriage bonus.) Why, then, haven't we scrapped the joint return—which is a cause of the marriage tax and bonus—and moved to a system of individual filing or to some other system which would effectively end the problem once and for all?

TABLE 1

Rate Schedules for 1988 Under TRA86

Taxable Income

Marginal Tax Rate	Joint	Separate	Single	Head of Household
15%	$ 0- 29,750	$ 0- 14,875	$ 0- 17,850	$ 0- 23,900
28%	$ 29,750- 71,900	$ 14,875- 35,950	$ 17,850- 43,150	$ 23,900- 61,650
33%*	$ 71,900-171,090	$ 35,950-124,220	$ 43,150-100,480	$ 61,650-145,630
28%	$171,090-	$124,220-	$100,480-	$145,630-

TABLE 2

Standard Deductions for 1988

Type of Return	Standard Deduction
Joint	$5,000
Separate	$2,500
Single	$3,000
Head of Household	$4,400

12. *See* H. ROSEN and G. ESENWEIN, *supra* note 10.

Nonneutralities, or inefficiencies, are features of a tax system that penalize or reward taxpayer actions that theoretically should not have such consequences. *See* W. KLEIN, POLICY ANALYSIS OF THE FEDERAL INCOME TAX 121-26 (1976).

* The top of the 33 percent bracket depends upon the number of exemptions. The schedules for joint and head of household returns are based on the assumption of two exemptions; those for separate and single returns assume one exemption. For each additional exemption, the 33 percent bracket is increased by $10,920.

Table 3. Marriage Penalties or Bonuses Under H.R. 3838
Percentage by Which Joint Tax Liability Exceeds That of Two Singles
IRA Provisions Not Included

	Percentage of Income Earned by Each Spouse									
	50/50		60/40		70/30		80/20		100/0	
Income Levels	Current Law	H.R. 3838	Current Law	H.R. 3838	Current Law	H.R. 3838	Current Law	H.R. 3838	Current Law	H.R. 3838
$20,000	5.38%	9.83%	5.81%	9.83%	4.81%	9.83%	(.93%)	.42%	(29.15%)	(26.26%)
30,000	7.30	4.94	6.54	4.94	2.42	4.94	(4.51)	(.22)	(26.99)	(32.57)
40,000	10.04	7.20	4.29	3.62	4.70	(6.76)	(3.10)	(15.25)	(24.41)	(35.40)
50,000	12.19	15.98	11.03	9.91	7.70	.51	(.74)	(7.40)	(22.23)	(26.45)
60,000	13.66	11.22	11.73	11.22	8.58	4.28	.11	(3.25)	(20.59)	(23.73)
70,000	16.17	8.64	12.26	8.64	9.02	6.21	.59	(3.54)	(19.49)	(22.06)

Source: Calculated by CRS. Tax Year 1988. Assumes wage and salary income only and use of the standard deduction. Marriage bonuses appear in parentheses.

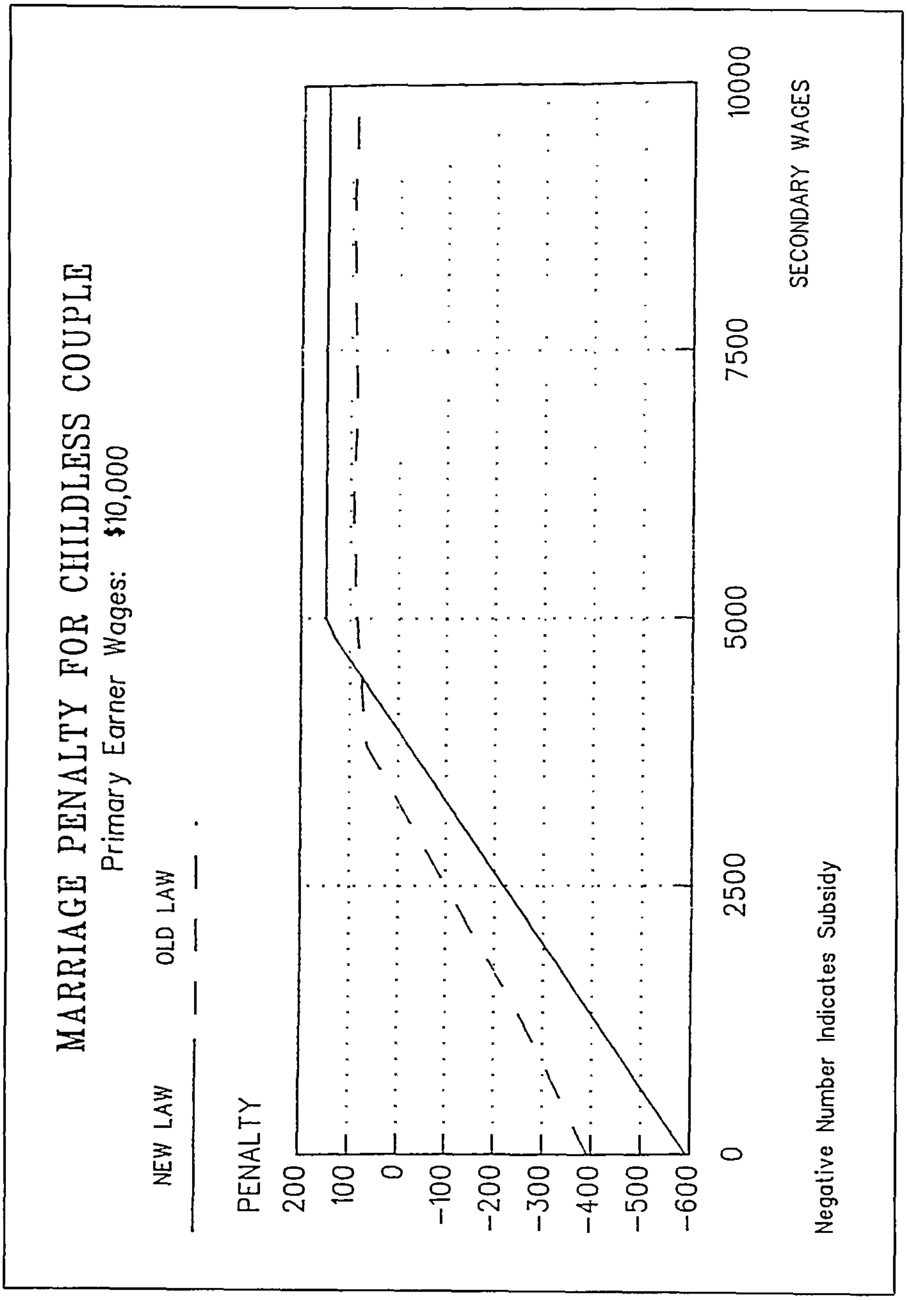
MARRIAGE PENALTY FOR CHILDLESS COUPLE
Primary Earner Wages: $10,000
NEW LAW
OLD LAW
PENALTY
200
100
0
-100
-200
-300
-400
-500
-600
0
2500
5000
7500
10000
SECONDARY WAGES
Negative Number Indicates Subsidy

Figure 1

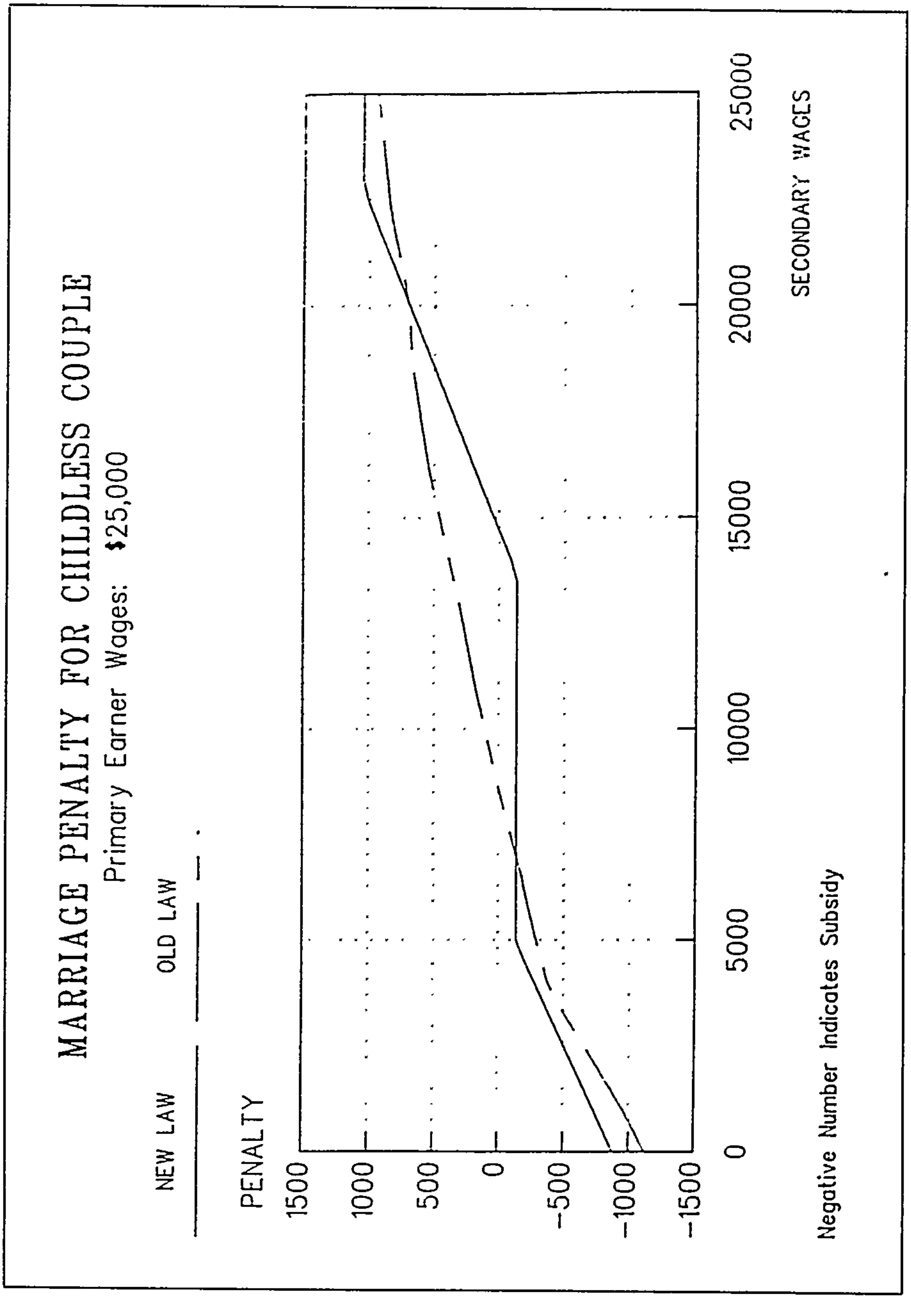
MARRIAGE PENALTY FOR CHILDLESS COUPLE
Primary Earner Wages: $25,000
NEW LAW
OLD LAW
PENALTY
1500
1000
500
0
-500
-1000
-1500
0
5000
10000
15000
20000
25000
SECONDARY WAGES
Negative Number Indicates Subsidy

Figure 2

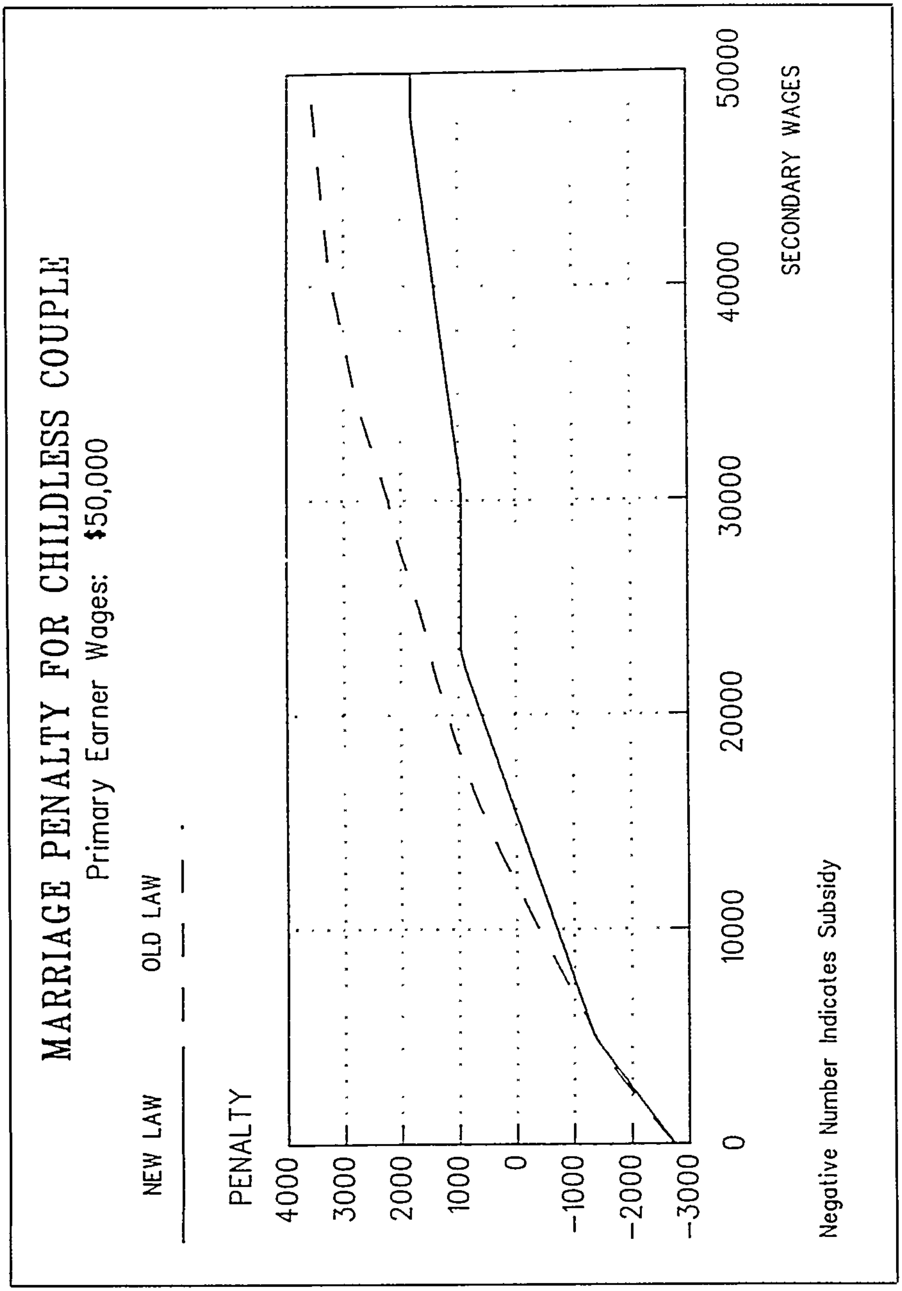
MARRIAGE PENALTY FOR CHILDLESS COUPLE
Primary Earner Wages: $50,000
NEW LAW
OLD LAW
PENALTY
4000
3000
2000
1000
0
-1000
-2000
-3000
0
10000
20000
30000
40000
50000
SECONDARY WAGES
Negative Number Indicates Subsidy

Figure 3

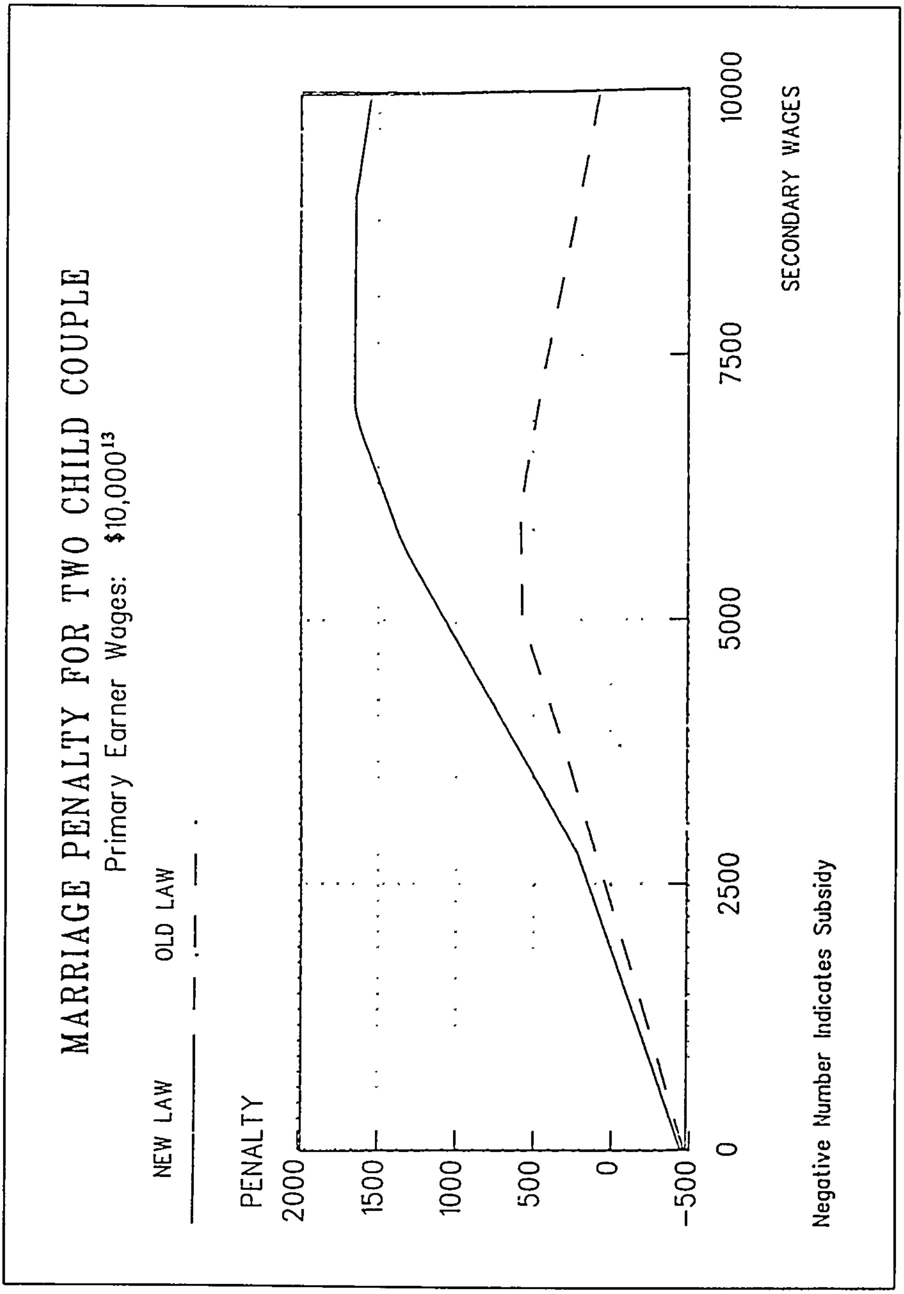

Figure 4

13. Rosen explains the enormous tax disparity in this manner. *See* H. Rosen *supra* note 10. "The increase is partly due to the fact that the standard deduction on a joint return is $2,400 less than the sum of the deductions on head of household and single returns. In addition, the spouse who was taking the earned income credit finds the amount of the credit reduced, perhaps to zero." *See infra* note 58, for an exposition of the earned income credit.

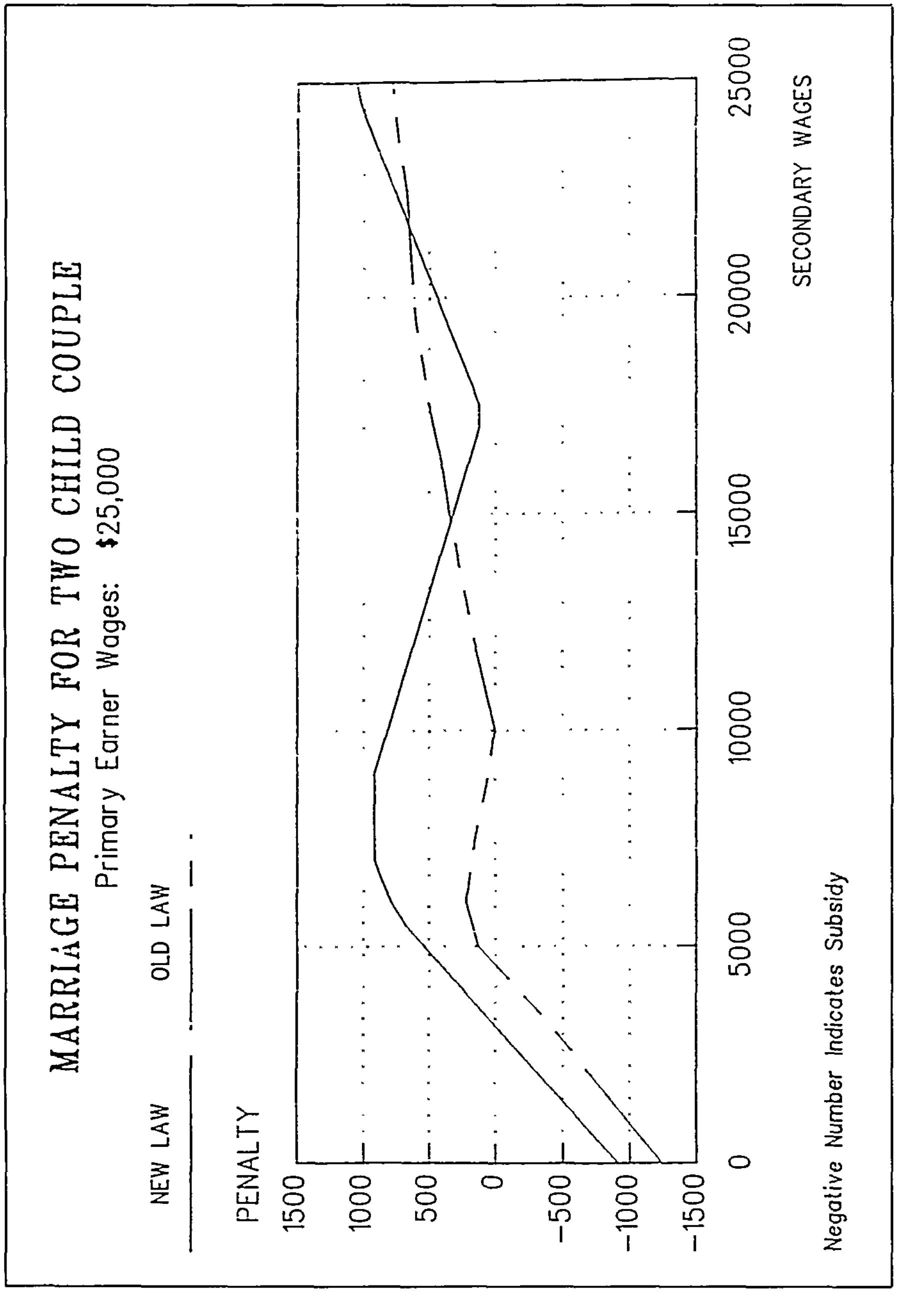
MARRIAGE PENALTY FOR TWO CHILD COUPLE
Primary Earner Wages: $25,000
NEW LAW
OLD LAW
PENALTY
1500
1000
500
0
-500
-1000
-1500
0
5000
10000
15000
20000
25000
SECONDARY WAGES
Negative Number Indicates Subsidy

Figure 5

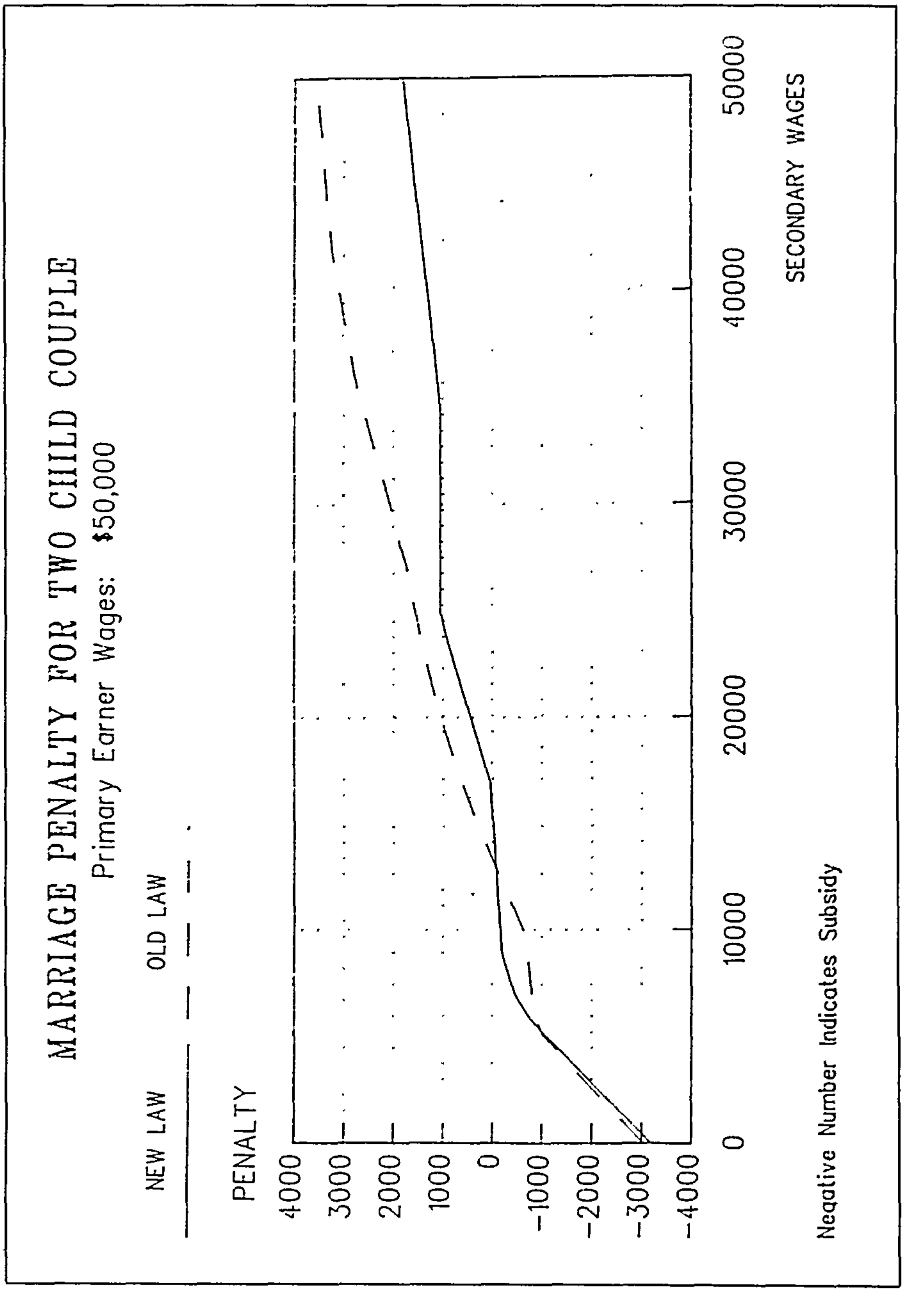
MARRIAGE PENALTY FOR TWO CHILD COUPLE
Primary Earner Wages: $50,000
NEW LAW
OLD LAW
PENALTY
4000
3000
2000
1000
0
-1000
-2000
-3000
-4000
0
10000
20000
30000
40000
50000
SECONDARY WAGES
Negative Number Indicates Subsidy

Figure 6

II.

The Internal Revenue Code's current treatment of marriage is the product of two objectives, a tax-equal system and a progressive tax structure. The former goal refers to the desire to equalize the tax burdens on married couples by attributing one-half of the family income to each spouse, regardless of the relative spousal contributions to that income. Thus, under tax equality, couple A with each spouse earning $25,000 would be taxed the same as couple B with income of $50,000, all of which is earned by one spouse.

The essential rationale for a tax-equal system is that income taxes should be imposed on the person receiving the benefits of the income. Arguably, since spouses ordinarily share in the enjoyment of (or in the decision-making regarding the disposition of) the income, the relative contributions of the parties should have no tax significance, even if the split is 100% to 0%.

Another argument in favor of income splitting between spouses is that it is often exceedingly difficult to allocate income and deductions, particularly itemized deductions, to the appropriate spouse.[14] Compounding the problem is the similarity, if not identity, of economic interests between spouses, which would allow (and has allowed) taxpayers who are taxed individually to reduce taxes through inter-spousal transactions. The assumed sharing of income and expense — and the related notion of ignoring sales between spouses — bypasses these concerns.

The rationale for a progressive tax structure is more theoretical. At least two arguments have been advanced. The first is that each person has diminishing marginal utility for income so that a progressive system results in minimum overall sacrifice.[15] The second,

14. To solve the problem of allocating itemized deductions, commentators have suggested splitting these deductions evenly, allocating them in relation to income or even allowing taxpayers to make their own allocations as did N.Y. State on its tax returns. For analogous proposals regarding allocation of income from property, see Brazer, *supra* note 5.

15. For the landmark article rejecting this first argument, see Blum & Kalven, *The Uneasy Case for Progressive Taxation*, 19 U. Chi. L. Rev. 417 (1952). *See also*, Blum, *Revisiting The Uneasy Case for Progressive Taxation*, 60 Taxes 16 (1982). For a more general view of the area, see W. Klein, *supra* note 12, at 12-32.

and more persuasive argument is that progression is a rational response to the fact that (notwithstanding the old adage about the requirements for success) rewards in our economic system are really a function of inspiration as well as perspiration. Since, *ex ante*, no one can know the measure of his vision, progression is an insurance policy which eases the tax burden of those who come up short in the lottery for native gifts.

In addition to tax equality and progression, most authorities who have dealt with these issues contend that, ideally at least, yet another objective should be sought — marriage neutrality. This principle holds that marriage is not an act undertaken for business purposes; therefore, it should have no effect on the tax cost to taxpayers who choose to marry. Since the existing tax system produces both marriage taxes and marriage bonuses, the goal of the marriage neutrality is not being met.

It would be helpful if all three objectives could be achieved simultaneously. Unfortunately, as Professor Bittker and others have shown, these objectives cannot coexist in one tax system. The following example should help illustrate the point. Consider A and B, singles, each of whom makes $50,000. Under the principle of tax equality, they should, if married, pay a total tax equal to the tax paid by couple C and D, whose $100,000 income is all attributable to C. To give effect to marriage neutrality, C and D married would have to be taxed in the same amount as C and D unmarried. Thus A and B, singles with income of $50,000 each, would have to pay the same tax as C and D, singles, where C earns $100,000 and D earns $0. However, this can be true only if the progressivity in the system is eliminated.

Some commentators have taken the position that tax equality should be eliminated; others would not give any effect to marriage neutrality. There is theoretically no pure way out of this dilemma. Taxing individuals on their enjoyment of income, limiting distortion, and reducing administrative burdens are all time-honored tax goals. If the three objectives cannot be simultaneously accomplished, how do we rank them to determine which should be sacrificed?

As a practical matter, the progressive structure of the tax system is probably beyond challenge; there is no significant constituency for it. Moreover, studies have shown that many taxpayers are able to mitigate the progressivity of tax rate schedules through good tax planning.[16] The possibility exists, then, that eliminating the progressivity in the rate structure might make the effective tax rates of the wealthy lower than those of the middle class. To be sure the research referred to is not current and the game rules have changed in recent years — for example, the capital gains deduction has been eliminated. Nevertheless, it would seem that until there is good evidence of a diminution of the effectiveness of tax planning, elimination of progressivity is not desirable.

Critics of tax equality — the marriage policy embedded in the Code — argue that evidence of income sharing by spouses is really inconclusive. They point to the divorce statistics, which no doubt have caused many spouses to hesitate before fully sharing their income and accumulated wealth, and to the increase in the use of antenuptial agreements. To further support the proposition that marriage neutrality is more important than tax equality, contemporary critics cite the trend away from the classical model of the working husband and stay-at-home wife.[17] Arguably, this trend, which by all accounts is expected to continue, suggests greater financial independence of spouses.

There are other arguments against tax equality. A number of studies have shown that the wage elasticity of the supply of labor for the "incremental" wage earner (for convenience, the wife) in the family is quite high.[18] Since the wife's earnings are added on to

16. See graph in R. GOODE, THE INDIVIDUAL INCOME TAX 224 (rev. ed. 1976) and accompanying text.

17. *See infra* notes 125 and accompanying text.

18. *See* Boskin & Sheshinski, *Optimal Tax Treatment of the Family: Married Couples*, 20 J. PUB. ECON. 281 (1983); Hall, *Wages Income and Hours of Work in the U.S. Labor Force*, in INCOME MAINTENANCE AND LABOR SUPPLY 102-62 (G. Cain & H. Watts eds., 1973); Hausman & Poterba, *Household Behavior and Tax Reform*, 1 J. ECON. PROSPECTIVES 105-08 (1987).

One can't help but wonder whether these studies are now out dated. Whereas once upon a time the wife's income may have been seen as discretionary, it would seem now that her income is largely viewed as essential. If so, she will come into the work force regardless of tax rate or her income; perhaps she will work harder to earn the target number of dollars upon which the family agrees. In more technical terms, of course, we are talking about a wife who was subject to the "substitution effect" now displaying classical "income effects." *See* W. KLEIN, B. BITTKER & L. STONE, FEDERAL INCOME TAXATION 29 (1987) for a brief discussion of these concepts.

the husband's, the tax on her is often going to be greater than it would be if she were able to file as a single. As a result, it is argued, "second" earners are not entering the market in the numbers they otherwise would.[19] This distortion against market work, it is further argued, is compounded by the fact that the value of homemaking services is not imputed to the family, which causes a related, though different, inequality — one between the tax positions of the one-earner and two-earner couples. The latter can purchase homemaking services in the marketplace only with after-tax income. The same bias against the two-earner family is made worse, it is claimed, by the fact that, unlike in the case of the classical family, in the two-earner family both spouses have nondeductible work expenses such as business clothes, commuting, and restaurant lunches.[20]

Perhaps the strongest argument against the tax-equality principle is that, as will be demonstrated, it can lead to the marriage tax. Why, ask marriage neutrality proponents, should two equal-earning taxpayers pay more tax simply because they marry? The only explanation offered is that, unlike singles, married people live together and thereby benefit from economies of scale. The vulnerability of this explanation, of course, is that singles also frequently live together, whether romantically or not, and married couples often live apart.[21]

Having evaluated the various objectives, we are left with the problem of choosing between two objectives, each with significant virtues and limitations, a problem that tax theory does not provide much help in resolving. If the system adopts tax equality (*i.e.*, income splitting), it tends to disadvantage two-earner couples. If the system selects marriage neutrality as its guiding principle, it is not giving effect to the likely sharing of income by spouses and is over-

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19. *See* Munnell, *The Couple versus the Individual Under the Federal Personal Income Tax*, in THE ECONOMICS OF TAXATION 250 (H. Aaron & M. Boskin eds. 1980).

20. Bittker has argued, *supra* note 5, at 1435, that if the tax system is concerned about employment expenses, it should do something for all wage earners not only those who happen to be married. Fair enough. But the denial of commuting expense deductions may present a special problem. The theory of this denial is that a taxpayer can choose to live close to his place of business and thereby avoid commuting expense. The two-earner couple, however, cannot eliminate commuting costs if the spouses work at separate locations.

21. *See* Bittker, *supra* note 5, at 1452-55.

taxing one-earner couples. Accepting the notion that "a page of history is worth a volume of logic"[22] it should be instructive to go back in time and see how the problem has been solved in the past.

From 1913 to 1948, there was no marriage tax or bonus; marriage neutrality held sway. Every individual filed a return reporting his or her own income. In the interest of convenience, married taxpayers could file jointly; but inasmuch as there was only one rate schedule for all taxpayers, if a second spouse had income of his or her own, a joint return would produce a higher family tax than would separate returns.

One of the major tax controversies that arose in the first half of this century was whether the tax law should recognize the 50/50 split of income effected by community property law. The issue was resolved in 1930 when the Supreme Court held in *Poe v. Seaborn*[23] that community property law should be honored.

In following years as tax rates increased to finance the war, concern grew that, because income splitting was not available to everyone, taxpayers in common law states were providing a massive subsidy to those in other states. In 1948, after much debate, Congress enacted legislation allowing married taxpayers in all jurisdictions to file joint returns. The tax on the couple was made equal to the total tax which would have been imposed on two singles, each with one-half the combined income. Tax equality became the new congressional marriage policy.

The result was a marriage bonus and a singles tax; for, given the progressive tax structure, a single with $20,000 of taxable income could save a great deal of money by marrying. And the tax savings would be greatest if he married someone with no income at all.

In the 1960's came recognition that the rates might be unfair to singles. Under some circumstances it was found that a single with the same income as a married couple might find his tax liability as much as 40% higher. The result of this raised consciousness was

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22. New York Trust Co. v. Eisner, 256 U.S. 345, 349 (1921) (Holmes, J.).
23. Poe v. Seaborn, 282 U.S. 101 (1930).

that in 1969, effective for calendar year 1971, a new rate schedule was adopted for singles only which ensured that taxes for this class would be no higher than 20% above that for marrieds with the same income.[24] The tax system was still structured on a theory of tax equality; but, as a result of this development, a marriage tax was now possible as well as a marriage bonus. Thus, married taxpayers ended up paying less tax than a single with the same income, but more tax than two singles each with one-half that income.

This state of affairs persisted until 1981. Congress in 1980, taking a further look at the relative tax burdens of singles and marrieds, decided to alleviate the perceived burden on two-earner families. Departing from tax equality, which was partially responsible for the problem, Congress enacted I.R.C. § 221 which provided a deduction to the family in an amount equal to 10% of the earned income of the lesser-earning spouse. This deduction was limited to $3,000 per year and moved the system in the direction of marriage neutrality, at least for working couples.

The two-earner deduction was repealed by TRA 86 effective for 1987. This, of course, simply returned tax equality to its earlier prominence. The Joint Committee on Taxation explained the change this way: "Adjustments made in the standard deduction for married individuals filing jointly and in the relationship of the rate schedules for unmarried individuals and married individuals filing joint returns are intended to compensate for the repeal of this provision."[25]

In short, as social conditions have changed, we have gone from marriage neutrality to tax equality, away from tax equality and back to it. Notwithstanding all the turmoil, no major damage seems to have been done to the system. Thus it seems likely that, as society

24. Adoption of a separate schedule for singles and marrieds—as the United States has done—is not universal. In Canada the taxpaying entity is the individual, not the couple. (And there are limitations on the tax effects of intra-family transfers). In Great Britain married couples are (for the most part) the taxpaying unit and use the same rate schedule as singles. In France income is split among the earner, the spouse and minor children; the total tax is the sum of the tax computed for each family member using the same tax schedule. For additional details on the tax structure of these foreign countries, see Dulude, *Taxation of the Spouses: A Comparison of Canadian, American, British, French and Swedish Law*, 23 OSGOODE HALL L.J. 67 (1985).

25. *See* STAFF OF JOINT COMM. ON TAXATION, SUMMARY OF CONFERENCE AGREEMENT ON H.R. 3838 (1986).

continues to change, "there [will] be no peace here, only an uneasy truce."[26]

III

Though we cannot achieve a consensus on the fairness of the joint return rates relative to those for the unmarried, we are not completely stymied in our ability to evaluate the tax system's overall fairness to singles and marrieds. As has been suggested, the Code is full of provisions which tie tax liability to marital status. So let's look broadly beyond the rate schedules at how the tax system copes with the problems of marriage.

Operating in a number of distinct patterns, a score of rules affect the tax burden of individuals who marry. The provisions briefly described and characterized below are not meant to be exhaustive. Rather they have been selected for their financial or conceptual importance. The rationales underlying these rules, as indicated at the outset, will be examined in part IV.

A. The Aggregation Model

In general, the tax system taxes the couple on the aggregate of the separately-calculated taxable income of the individuals. This combination of tax attributes is ordinarily quite simple, requiring only addition and subtraction. When there are business dealings between spouses, the model is frequently not applicable; nevertheless, the aggregation model would apply, for example, when the wife hires the husband to work in her business. She would have a deduction and he would have income in the amount of the salary.[27] In like manner a loan between spouses would produce interest expense and interest income.[28] The joint return rules, of course, provide for such aggregation.

26. *See* Bittker, *supra* note 5, at 1443.

27. Munroe v. Commissioner, 32 B.T.A. 995 (1935), holds the wife has a deduction. The husband's tax position is presumably determined under I.R.C. § 61(a)(1) (1987).

28. Shapiro v. Commissioner, 29 B.T.A. 1012 (1934), holds the interest is deductible by husband. Interest income is includible under IRC § 61(4) (1987). For Social Security purposes wages paid to a spouse are not subject to I.R.C. § 3121(b)(3)(a) (1987).

It should be noted that under current law these items will not necessarily offset one another. *See* limitations on deductibility of interest in I.R.C. § 163 (1987). In the case of an interest free (or below market rate) loan between spouses, I.R.C. § 7872(f)(7) ensures that there will be no adverse consequences to married couples.

Calculating and combining the separate income of the spouses is not the only way the aggregation principle operates. Where deductions are curtailed by a percentage of adjusted gross income (AGI), the aggregation principle requires that the *combined* income be subject to the limit. Thus, instead of applying the 7.5% (of AGI) floor on the separate incomes of husband and wife to determine the medical deduction, the law requires that the 7.5% floor be applied to the total AGI of the parties.[29] Working the same way are the 10% floor for casualty losses[30] and the various percentage ceilings for charitable contributions.[31]

I.R.C. § 1244, which limits deductions to a specific dollar amount rather than to a percentage of income, operates similarly. Under this section an unmarried taxpayer can deduct up to $50,000 per year for losses on sales of certain stock. If the taxpayer is married, the family limit is $100,000; and it is of no significance whose sales generated the loss. This, of course, is a result that would be expected under aggregation theory.[32]

B. *The Merger Model*

1. Basic Applications

The model just described does not exhaust the congressional scheme for taxing husband and wife. In the face of general awareness that money-related issues are a major source of marital disputes,[33] the tax law assumes for a number of purposes that the spouses

29. I.R.C. § 213(a) (1987).

30. *Id.* § 165(h)(2)(a) (1987). While this provision is illustrative of the aggregation model, I.R.C. § 165(h)(4)(b) illustrates the merger model, discussed, *infra*. This latter rule provides that couples filing joint returns will be subject to only one $100 deductible on casualties involving personal use assets, I.R.C. § 165(h)(1) (1987).

The aggregation model is put to the test by I.R.C. § 165(e) (1987) which provides for a deduction in cases of theft. Can one spouse steal from another? The statute is silent on this matter. The cases, while not foreclosing the possibility of such treatment, have as yet, it appears, to allow a deduction.

31. I.R.C. § 170(b) (1987).

32. We shall soon see, however, that this is the exceptional result; in most cases where tax benefits are subject to dollar limitations, the allowance granted to the couple is not simply twice that alloted to the unmarried individual.

33. Letter from Ann Landers to the author (Sept. 29, 1987): "It is certainly safe to say that the spending (or not spending) is a factor in many marriage disputes . . . . My column is about as good a source [for this] as you can find."

are models of financial cooperativeness. This device allows the system to treat spouses in the same way that corporate law deals with merged corporations, as one entity (with one economic interest) into which the separate identities of the participants are dissolved.

The assumption of unity operates most dramatically where the spouses interact economically. The gift and estate tax marital deduction[34] provisions are good illustrations. They shelter all intra-couple transfers of wealth from transfer taxes. The income tax has analogous rules; no gain (or loss) is recognized on transfers of assets between spouses[35] (sometimes between ex-spouses as well). Another rule protects a spouse who wishes to effect a transfer of stock in an S corporation to the other spouse. Under current law husband and wife count as one shareholder so that there is no risk of exceeding the thirty-five shareholder limit on such a transfer.[36]

Spousal status can be significant in other family financial planning areas as well.[37] For instance, there is a special provision which, under certain circumstances, can reduce the estate tax valuation of farm property and closely held businesses.[38] The principal condition for this favorable treatment is that the property in question be left to a "qualified heir" such as the spouse.[39] Also benefiting tax planners are the gift splitting rules[40] which provide that, where spouses

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34. I.R.C. §§ 2523 & 2056 (1987).

35. *Id.* § 1041 (1987). The House Committee report explaining § 421 of the Tax Reform Act of 1984 had this to say: "The Committee believes that, in general, it is inappropriate to tax transfers between spouses. This policy is already reflected in the Code rule that exempts marital gifts from the gift tax, and reflects the fact that a husband and wife are a single economic unit."

The report explains further that Congress wanted to override United States v. Davis, 370 U.S. 65, *reh'g denied*, 371 U.S. 854 (1962), which had held that the transfer of appreciated property in a property settlement was a taxable event.

36. I.R.C. § 1361(a)(1), (c)(1) (1987).

37. Sometimes spouses want to rearrange ownership interests in a residence. Suppose husband and wife are living in a home owned by the husband alone and they wish to move to another home in which they will be joint owners. Under the general rule of I.R.C. § 1034 (1987) rollover of gain is allowed only where the same taxpayer owns the house before and after the sale. Nevertheless I.R.C. § 1034(g) (1982) allows an election to qualify for rollover benefits presumably on a theory that technical ownership of a home is too trivial a matter for tax consequences to hinge on when both spouses are living in the home. Treas. Reg. 1.1034-1(b)(3) (1987). The regulation also allows spouses who own a residence jointly to purchase a new residence in the name of only one of them.

38. I.R.C. § 2032A (1987).

39. A "qualified heir" can also be a child or a sibling. *Id.*

40. *Id.* § 2513(a)(1) (1987). Gift splitting is also available for generation skipping purposes. I.R.C. § 2652(a)(2) (1987).

make the election, each spouse will be deemed to have made a gift equal to one-half the value of property transferred.

If spouses can share tax-freely in family savings and investment, they can similarly share in the rewards of family employment. The Internal Revenue Code often allows a non-employee spouse to piggy-back on certain tax benefits allowed to an employee-spouse. If the employee-spouse qualifies, the other spouse can enjoy tax-free meals and lodging,[41] legal advice,[42] and other statutory fringe benefits.[43]

The merger principle, however, works against taxpayers at least as often as it works for them, as is evident from the following provisions. Consider first the grantor trust rules. Under TRA 86, if a taxpayer creates a five-year trust for the benefit of his adult children and provides for a remainder to his spouse, the settlor is treated as if he had retained the remainder for himself with the result that he is taxed on trust income.[44] Prior to TRA 86, this would have been a successful spousal remainder trust with no attribution made to the grantor. (Of course, both before and after TRA 86 if the estate following the term of years had been given to anyone besides the grantor or the grantor's spouse the income would be taxed to the children.)

Under the new grantor trust rules, almost any significant power or interest held by a a grantor's cohabiting spouse is attributable to the grantor.[45] Thus, trust income would be taxable to the grantor if his cohabiting spouse holds a power to control the beneficial enjoyment of income,[46] a prohibited administrative power,[47] or a power of revocation.[48]

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41. *Id.* § 119(a) (1987).
42. *Id.* § 120 (1987).
43. *Id.* § 132(f)(2) (1987).
44. *Id.* §§ 673(a) & 672(e) (1987).
45. *Id.* § 672(e) (1987).
46. *Id.* § 674 (1987).
47. *Id.* § 675 (1987).
48. *Id.* § 676 (1987). Also affecting grantors of trusts, I.R.C. § 643(f) (1987) requires that husband and wife be treated as one person for a different purpose. If both spouses create trusts for the same beneficiaries and the "principal purpose" of these trusts is tax avoidance, the trusts will be merged so as to eliminate the advantages of income splitting under I.R.C. § 1(e) (1987).

The rules pertaining to redemption of securities carry over the same idea of family attribution (also to the tax detriment of the family). Except in the case of a complete termination of interest,[49] a taxpayer is treated as owning all the stock held by his spouse.[50] As a result of this contructive ownership, it is often difficult to claim a "substantially disproportionate" redemption (or a redemption "not equivalent to a dividend") and thus to qualify for capital, as opposed to ordinary income, treatment under I.R.C. 302(b)(2) (or (b)(1)).[51]

If a taxpayer sells a security at a loss and repurchases it within thirty days, the loss is deemed artificial; he cannot claim it.[52] Likewise, if the taxpayer's spouse buys back the security, the loss is not available.[53] Here again action by one spouse is attributed to the other.

Security owners are also adversely affected by the rules defining personal holding companies[54] and controlled corporations.[55] For these purposes,[56] husband and wife are treated as one shareholder. Thus, two married taxpayers are more likely to be subject to these provisions than two unmarried ones.

The merger model probably works most frequently to limit deductions available to married taxpayers. For example, I.R.C. § 179, which allows taxpayers a deduction of up to $10,000 for certain purchases of depreciable assets, treats the married couple as only one taxpayer, that is, eligible for only one such deduction.[57] Sim-

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49. *Id.* § 302(b)(3) (1987).

50. *Id.* § 318(a)(1)(A)(i) (1987).

51. It is still important to know whether a redemption produces capital gain or dividend income because after offsetting capital gains, capital losses can be used only to offset a limited amount of ordinary income. *Id.* § 1211 (1987). It is more obviously important to distinguish between capital loss and dividend income. This problem of characterization could come up where the redemption price is less than the losses of the shares redeemed.

52. *Id.* § 1091(a) (1987).

53. McWilliams v. Commissioner, 331 U.S. 694 (1947).

54. I.R.C. §§ 541-547 (1987).

55. *Id.* §§ 1561-1563 (1987).

56. *See supra* note 36 and accompanying text for application of the same principle in S corporations situation.

57. Treas. Reg. § 1.179-2(e) (1987).

ilarly, married couples are limited to a deduction of $25 per donee for business gifts, the same as singles.[58]

I.R.C. § 121 takes this two-marrieds-as-one-single notion a step further. If joint unmarried owners comply with § 121 residency and age requirements, they are *each* entitled to an exclusion of $125,000. If they are married and sell the homestead at a gain they are entitled to only one $125,000 exclusion.[59] Moreover, if one spouse owns the homestead and marries a person who has previously exercised her § 121 election, the first spouse forfeits his right of exclusion.[60]

The capital loss and passive loss rules continue in this vein. If joint, unmarried owners of a capital asset sell it at a loss, each is able to offset up to $3,000 against ordinary income.[61] If, however, they are married, only one $3,000 loss allowance is available. The passive loss rules,[62] which are somewhat more complex, have even harsher effects. If an unmarried taxpayer owns rental real estate whose management he "actively participates in," he is entitled to an annual deduction of up to $25,000 against non-passive income for any losses he may incur. This loss starts to be phased out at the AGI level of $100,000 and is completely disallowed once AGI reaches $150,000.[63] For married couples the deduction limit and phase-out points are identical to those for the single taxpayer.

2. Limitations on the Merger Model.

In the family financial planning area, as we have seen, most of the rules are premised on an assumption of the identity of spousal interests. Consider, for example, the case of the husband who creates

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58. I.R.C. § 274(b)(1), (2) (1987).

Though not providing a limitation on deductions, the earned income credit (I.R.C. § 32 (1987)) offers a similar illustration of merger theory. Under this provision, the credit, which is refundable, is equal to 14% of the first $5,714 of earned income (for a maximum credit of $800). The credit is subject to a 10% reduction for each dollar of AGI or earned income, whichever is higher, in excess of $6,500. Pertinent to the analysis here is that the beginning phase-out point is the same for marrieds and singles.

59. I.R.C. § 121(b) (1987).

60. *Id.*

61. *Id.* § 1211 (1987).

62. *Id.* § 469 (1987).

63. *Id.* § 469(i) (1987).

an inter vivos sprinkle trust for the benefit of his children, and naming the wife as trustee. On a merger theory the power to designate beneficiaries given to the wife is attributable to the husband; and, under grantor trust rules, he is treated as the owner and is taxed on trust income.[64] However, for estate tax purposes, the power given to the wife is not attributed to the husband to force inclusion of the trust property in his estate.[65]

The same assumption of the economic independence of the spouses underlies another estate tax rule. Consider a husband who transfers property in trust for the benefit of his wife during his life with remainder over to their children. Some time later he dies. The property is not includible in his estate even though the grantor had essentially reserved a life estate, a measure that ordinarily forces inclusion of property in the estate under I.R.C. § 2036.[66]

The child care credit[67] rules show a different kind of limitation of the merger model. Under these rules a credit is available for "employment-related expenses" (*i.e.*, costs of supervising children so that an adult can work). In the case of a married couple, "qualifying" expenses for purposes of calculating the credit are limited to the income of the lesser-earning spouse. In the case of a single taxpayer his earnings are the limit. Practically speaking, of course, the distinction is understandable; in a one-earner marriage the stay-at-home spouse can provide the child care services, which is not so in the case of the single taxpayer who presumably lives alone. For our purposes, it is worth noting that the couple is not literally treated as one individual under these circumstances.[68]

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64. *See supra* notes 44-48 and accompanying text.

65. I.R.C. § 2038 (1987) would force inclusion if the donor had retained the power himself.

66. *Id.* § 2036 (1987). This is an interesting result. If we accept the assumption that income is shared, then A to A's spouse for the life of A, remainder to B is similar to the creation of two trusts:

1. A to A for life, remainder to B, and
2. A to A's spouse for A's life, remainder to B.

If the disposition had taken this form, there would be no question that the value of the property in trust would be includible in A's estate. Nevertheless, in the above hypothetical, property is not includible in the estate.

67. *Id.* § 21 (1987).

68. I have focused on the departure from the merger model here though, in fact, I.R.C. § 21

As a final departure from the merger model, the set of net operating loss rules must be considered.[69] These rules function much like the Code provisions limiting loss carryovers of corporations that are acquired or which are parties to a reorganization.[70] A surviving spouse who incurs a loss after the other spouse's death may not carry the loss back to a joint return year in which the income had been earned entirely by the deceased spouse.[71] Similarly, a net operating loss sustained by one spouse prior to marriage cannot offset the other spouse's income on a joint return.[72] Trafficking in "loss" spouses — as in loss corporations — is not condoned.

C. *The Married Couple as One and One-Half People*

There is a third model used by Congress in dealing with married taxpayers. This approach is consistent with that used to derive the rate schedules, which tax the married couple more than two singles each with half the income, but less than a single individual with the same total income.[73]

Reference has already been made to the inclusion rule for social security benefits under which taxable income is triggered at the $25,000 level for individuals and at the $32,000 level for marrieds.[74] The alternative minimum tax exemption and beginning exemption phase-out points of $40,000 and $150,000 for joint filers, and $30,000 and $112,500 for singles, are another example.[75] Also serving to

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(1987) is based in part on the merger model. The child care credit is 30% of the employment-related expenses. If the adjusted gross income, however, is over $10,000, the 30% credit can drop as low as 20%. That $10,000 trigger point is the same for marrieds as for singles.

Perhaps this is the best place to mention the so-called "innocent spouse" rule which also has merger and nonmerger characteristics. In general, where couples file a joint return "the liability with respect to the tax shall be joint and several." I.R.C. § 6013(d)(3). The merger model would seem to demand this. The real world descends in the form of an exception. If there is a "substantial understatement of tax attributable to grossly erroneous items of one spouse" of which the other spouse "did not know, and had no reason to know," then the other spouse shall be relieved of liability. I.R.C. § 6013(e).

69. *See* Treas. Reg. § 1.172-7 (1987).

70. *See* I.R.C. §§ 381 & 382 (1987).

71. Zeeman v. United States, 395 F.2d 861 (2d Cir. 1968).

72. Calvin v. United States, 354 F.2d 202 (10th Cir. 1965).

73. *See supra* discussion in pt. II.

74. *See supra* note 7 and accompanying text.

75. I.R.C. § 55(d) (1987).

illustrate the one and one-half people model is the standard deduction — $5,000 for married couples contrasted with $3,000 for singles,[76] and the additional $600 standard deduction for each married taxpayer age 65 or blind contrasted with $750 for singles.[77]

In this regard, perhaps the most striking of TRA 86's changes are the amendments to the Individual Retirement Account (IRA) rules.[78] Under old law each spouse could deduct IRA contributions up to the higher of $2,000 or the amount of earned income. This deduction could be taken even if the spouses participated in another retirement plan. As a result of TRA 86 a deduction is harder to come by. If a married couple filing a joint return shows adjusted gross income of more than $50,000, and if either spouse is covered by an employer retirement plan, neither spouse can make deductible IRA contributions. The phase-out point for individuals, by contrast, is $35,000. Phase-outs begin at the $40,000 level for marrieds and $25,000 level for singles.[79]

D. *When Is Marriage "Effective" for Tax Purposes?*

If the tax rules relating to marriage are important, then it is also important to know when they apply, that is, when marriage is "effective." Here, too, there is no uniform approach; marital status may have to be determined differently depending on the specific rule in question. For example, for purposes of the $125,000 home-gain exclusion, the law looks to marital status at the time of sale.[80] The grantor trust rules apply if the taxpayer is married at the time of the transaction *and* the spouse is then living with the grantor.[81]

For purposes of eligibility to file a joint return, the tax law evaluates marital status at the end of the year;[82] but to determine the appropriate rate schedule and the standard deduction,[83] the law looks

76. *Id.* § 63(c)(2) (1987).
77. *Id.* § 63(f) (1987).
78. *Id.* § 219 (1987).
79. *Id.* § 219(g) (1987).
80. *Id.* § 121(d)(6) (1987).
81. *Id.* § 672(e) (1987).
82. *Id.* § 6013(d)(1) (1987).
83. *Id.* §§ 2(c), 63(g), 7703 (1987).

to that status for the last six months of the year. If, however, during this period taxpayers live apart from their spouses and maintain a household in which a dependent child resides, taxpayers are not "considered as married."

E. Social Security

Although this article deals with the income and transfer tax implications of marriage, it does not seem fitting to ignore social security considerations completely.[84] Under social security law, generally speaking, individuals are entitled to receive at age 65 a benefit equal to 1) that which they can claim based on their own contribution record or 2) 50% of their spouse's "primary insurance amount" based on such spouse's contribution record, whichever is greater. Much like the income tax, then, social security recognizes the special role of the spouse. By providing benefits to a spouse even if he or she has not worked (and hence has not paid into the system), these rules function like a marriage bonus.

The other side of this marriage bonus, however, is both a singles tax and a marriage penalty. To illustrate: Consider a married couple A and B. A worked until age 65 while B was a homemaker. Now consider C and D who each earned one-half as much as A. Because of spousal benefits A and B will usually receive more from the system than will C and D who are in the same economic position and who have contributed the same amount into the system. This is true regardless of whether C and D are single or married.[85]

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84. This summary is pieced together from the following sources: Reno & Upp, *Social Security and the Family*, in TAXING THE FAMILY 139-64 (R. Penner ed. 1983). A CHALLENGE TO SOCIAL SECURITY, THE CHANGING ROLES OF WOMEN AND MEN IN AMERICAN SOCIETY (R. Burkhauser & K. Holden, eds. 1982); W. ACHENBAUM, SOCIAL SECURITY VISIONS AND REVISIONS (1986).

85. The disadvantageous position of two-worker couples can be seen this way. When the second spouse in the family decides to work, he is receiving a net return that is less than a fair one for his dollar inputs. The reason is that much of what he receives from social security is what he would have received anyhow in the form of spouse benefits on the earnings of the first spouse.

It should be noted that some commentators have taken the position that social security is not as unfair to two-worker couples as has been made out because of certain insurance protections available to them that are not available to one-worker couples. *See Incremental Change in Social Security Needed to Result in Equal and Fair Treatment of Men and Women*, in A CHALLENGE TO SOCIAL SECURITY 235, 239 (R. Burkhauser & Holden, eds. 1982).

Thus, it is apparent that one-worker families are favored over two-worker families and singles. As to the treatment of singles relative to two-worker marrieds under the above formula, the result depends on whether the parties are alive. While the parties are alive, there will ordinarily be no difference in benefits, because spouses will be paid in accordance with their own work record which will provide them with more than 50% of the other spouse's entitlement. Thus marriage will confer no benefit. (There will be no difference in costs either if the income of each person is the same).

Upon the death of one of the spouses this result may change. Since the surviving spouse would be entitled to his own benefit or that of the deceased spouse, whichever is higher, the position of the surviving spouse may be improved if his personal benefit is less than that of the deceased spouse. Of course, the survivor of the unmarried couple would experience no change in benefits.

In sum, the income tax marriage penalty (narrowly defined) is not replicated in the social security area. If anything, two marrieds will come out ahead of their single counterparts in the social security lottery.

IV

Can any sense be made out of these varied rules which sometimes treat married couples as one person, sometimes as one and one-half, and sometimes as two people? We can begin with the simplest family tax problem — how to deal with transactions between spouses.

The argument has been made that at the core we are individuals, not component parts of a couple. For this reason and because of the weakening of marital ties and the growing financial independence of what used to be the stay-at-home spouse, the argument is that married people should be treated as autonomous individuals for tax purposes. The problem with this analysis, of course, is that notwithstanding some weakening of marital bonds, the marital knot is oftentimes still strong. Thus many inter-spousal transactions are purely formal. Unless the IRS regularly launched investigations into the quality of marriages, it would surely make a mockery of the tax system to allow a taxpayer to recognize losses — or to recognize gains and get a stepped-up basis — on transactions that have little or no meaning to the parties. This concern explains the applicable income tax rules on intra-couple transactions.[86] In the transfer tax area, this same concern is given as the reason for the unlimited marital deduction for transfers between spouses.[87]

The only difficulty with this explanation is that, notwithstanding the similarity of their implied and stated rationales, the rules in the income and transfer tax areas are profoundly different in one important respect. In the former, income is assumed to be shared regardless of what in fact transpires, while in the latter assets are treated as being shared only where in fact they are shared. In short, it is really only income that is assumed to be shared; capital is not.

If merger theory applied here in its pure form a testamentary gift by a spouse would result in a deemed transfer by each spouse of one-half of the property. Of course, the fact that capital is not deemed to be shared should not come as a surprise, for, in common law jurisdictions, once income is used for support, the remainder usually belongs (as capital) to the spouse who earned it. The other spouse's claim, far from being equal, is limited in value and is generally assertable only at the time of divorce or death.

The notion that capital is not shared may shed light on some of the limitations of merger theory that apply in the transfer tax area. For example, if a wife transfers property in trust for the benefit of her adult children giving the husband a power of invasion (also for the benefit of children) over principal, the husband's power over the property (capital) is not attributable to the wife for purposes of requiring some or all the property to be includible in her estate.

If capital is not deemed to be shared in law, classical merger theory has not really justified the estate and gift tax marital deduction. Does it justify the other tax rules examined here? Consider two unmarried taxpayers benefiting from the $10,000 deduction under I.R.C. § 179. Should they lose one of their deductions when

86. I.R.C. § 1041 (1987); *see also supra* note 35.
87. *Id.* §§ 2056 & 2523 (1987); *see also supra* note 35.

they marry?[88] The Code solution or merger theory is only really defensible if a slightly different set of facts is assumed. Suppose X and Y marry; X owns a business (that buys equipment) while Y is a spendthrift. Under marriage neutrality, X should not be entitled to $20,000 of § 179 deductions merely because of his marriage to Y.

The one and one-half person solution can be similarly challenged. Let's take A and B, singles, each of whom participates in a deferred compensation plan and has adjusted gross income of $22,500. Because each has less than $25,000 of AGI, each can contribute and deduct the full $2,000 to an IRA. If they marry, by contrast, under current limitations that become effective at $40,000 of adjusted gross income, each will be entitled to a deduction of only $1,000.[89]

Here again the logic of the statute is apparent only if somewhat different facts are assumed. Suppose A earns $2,000 and has no other income; B earns $43,000. Both participate in a deferred compensation plan. If the tax system simply doubles the ceiling of individuals to $50,000, both A and B would qualify for an IRA.[90] The problem is, of course, that if B had remained single, he would not have been eligible for the deduction. Under marriage neutrality, however, the fact of his marriage should not generate a deduction for him.

In effect the tax system is saying to A and B that it is treating them as a couple, applying tax-equality principles. (Of course, to the extent that each member of the couple must have earned income for IRA purposes,[91] *i.e.*, income earned by one cannot be shared, the rule is not tax equal but marriage neutral). As a result, it is inevitably going to be easier for the high earner to qualify for the IRA deduction. In exchange for this "generosity" — or perhaps more precisely to replace the income lost from it — the IRA imposes

88. *See supra* note 57 and accompanying text.

89. I.R.C. § 219(g) (1987).

90. *Id.*

91. Of course to the extent that each member of the couple must have earned income for IRA purposes (*i.e.*, income earned by one cannot be shared), the rule is not tax equal but marriage neutral. I.R.C. § 219(g) (1987).

a $10,000 lower ceiling on the couple ($40,000) than the total of the ceilings that would be applied to the individuals if they were unmarried ($50,000).[92]

It should be apparent that the Code's solutions and these explanations are still problematic. In the case of § 179 deductions, there is in effect a conclusive presumption of a "classical family" in which all the property is owned by one spouse. The couple is thus disadvantaged because it has no opportunity to demonstrate that each spouse might be entitled in his or her own right to the deduction.

The problem with the IRA solution is that while it is true that the high earner may benefit by the rule adopted, it is just as likely that the low earner will be hurt. By marrying, say, a $48,000 per year spouse, the $2,000 per year spouse loses the right to any deduction.[93] Also importantly for our purposes, beginning the IRA phase-out at $40,000 victimizes the two-earner couple, the one which ordinarily pays a high marriage tax (narrowly viewed).

Now that we understand the rationale for Congress's refusal to simply double deductions to all married couples, it seems useful to think about why Congress did not consistently adopt the same approach for all married couples. In other words, why doesn't the Code apply the dominant merger model to all provisions affected by marriage instead of selectively applying both that model and the one and one-half person model?

As for the rates, most theorists would deny that tax rates on marrieds and singles should be the same (as they were from 1913 to 1948) if a joint return is filed. The reason is that there is unavoidably less taxpaying capacity in the couple than in a single, if only because two people must be supported out of the same income. When this notion that two cannot live as cheaply as one is combined with the idea that marrieds enjoy economies of scale, the result under the rate schedules is that the married couple pays more than two singles each with one-half the same income, but less than a single

92. *Id.*
93. *Id.*

with the same income.[94] This approach is, of course, the one and one-half person model.

Like the rate schedules the standard deduction[95] applies to all taxpayers. The alternative minimum tax,[96] though affecting only selected (usually wealthy) taxpayers, nevertheless applies in lieu of the regular tax schedules. Since the rate schedule for marrieds is based on the one and one-half person model, so logically should these other provisions.

The IRA deduction[97] and social security inclusion rules,[98] which also embody the one and one-half taxpayer principle, require a somewhat different explanation. There is a fundamental distinction between these provisions and, for example, I.R.C. § 179 or § 1211 (limiting deductions for capital losses), which are illustrations of the merger model. In effect, what Congress is saying in § 179 and § 1211 is that deductions under these sections are "tainted," *i.e.*, that they would not be allowed under "pure" tax theory and are being allowed only for the limited purpose of simplifying tax return preparation.[99] By contrast, in the Social Security and IRA areas — whether or not this linkage is sound — the amount of income recognized or deduction allowed is a function of total, mostly "untainted," family income. This being the case, it would be grossly unfair for Congress to use the same number of dollars as phase-out points for singles and marrieds. Nevertheless, in the passive loss area, this is, inexplicably, precisely what Congress did.[100]

Why, depending on the substantive rule in question, should there be different times at which marital status must be examined? In the

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94. *See supra* discussion in pt. II.

95. I.R.C. § 63(c) (1987).

96. I.R.C. § 55 (1987).

97. *See supra* notes 78, 79, 89-95 and accompanying text.

98. *See supra* note 7 and accompanying text.

99. Presumably if both spouses operate businesses or own stock, they don't "need" the deduction; the couple can hire an accountant to keep appropriate bookkeeping records.

100. *See supra* notes 62 & 63 and accompanying text. It should be noted that this provision, like others that seem to work against the taxpayers, has features that turn out to benefit them. The passive loss rules *favor* marriage in that the deduction for passive losses of up to $25,000 is allowed even if the owner spouse doesn't "actively participate in" the rental activity, as long as his spouse does. I.R.C. § 469(i)(6)(D) (1987).

case of the home-gain exclusion[101] and grantor trust rules,[102] it does not seem unreasonable to look at marital status at the time of the sale or trust creation rather than at the end of the year. Otherwise a taxpayer engaging in a § 121 or § 671- § 677 transaction might be seriously harmed if he subsequently marries during the taxable year.[103]

Unlike the preceding substantive rules, the joint return provisions require that marital status be determined at the end of the year.[104] This rule is more problematical, for in giving effect to eleventh-hour marriage, it allows the taxpayer to manipulate the system to his advantage. In the vast majority of cases there is no issue of sham marriage; however, since there is virtually no "sharing" (or economy of scale), an important underpinning to the tax law regarding marriage is absent.

An approach similar to the one adopted by I.R.C. § 7703 seems preferable. Under that rule if a taxpayer lives apart from his spouse for the last six months of the year and supports a child who resides in his home, he is not considered married. One can quarrel with § 7703, which applies broadly in the Code, by asking why it should make a difference whether there is a child or not. But at least the six-month rule helps to define marriages that are economically real.

In sum, there are basically two types of tax rules as discussed in the preceeding section, those that provide special treatment for inter-spousal transactions and those that determine the way marriage will affect the availability of certain tax benefits, *i.e.*, whether the couple will be viewed as one, one and one-half, or two persons. For virtually all of these latter rules, it is irrelevant whether the benefits would have been available to the parties in question had they been single. The rules here, as in the case of the rates, reflect the Congressional policy of tax equality rather than marriage neutrality.

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101. *See supra* notes 59 & 60 and accompanying text.

102. *See supra* notes 44-48.

103. A rule looking to marital status at the end of the year would unnecessarily complicate matters for individuals whose divorces during the year produced settlements where trust powers were given by one spouse to the other.

104. *But see supra* note 83 and accompanying text.

V.

The tour and analysis of the marriage-related provisions of the tax law are over. Remaining only is the problem of determining the bottom line on the impact of marriage on tax liabilities.

As will readily be noted, the question of the overall marriage neutrality of the tax system does not allow a simple, comprehensive answer. To be sure, in the estate and gift tax area, marriage appears a clear benefit to taxpayers; the unlimited marital deduction,[105] split gift rules,[106] and special provisions applicable to owners of closely held corporations[107] all weigh heavily in favor of marriage. So do the transfer tax rules which allow trust powers and interests to be given to spouses without attribution back to the donor spouse. The reach of the transfer taxes, however, threatens only a small fraction of taxpayers, those with estates of more than $600,000.[108]

On the income tax side, a clear reading is unavailable, as is evident from consideration of the tax-free transfer rules between spouses. At first impression it would appear that the exemption from tax consequences is an overwhelming benefit to married taxpayers. After all, one of the reasons for the enactment of I.R.C. § 1041 was the unhappy experience with *United States v. Davis*,[109] which held that gain would be recognized upon the transfer of appreciated property by one spouse to the other as part of a property settlement.

It is not inconceivable, however, that parties in this position might want the transferor to incur the tax, perhaps because of offsetting losses during the year on other transactions. In this manner a high-bracket transferee could get a step-up in basis at no effective tax cost to the transferor. And, ordinarily, transferors would surely want to be able to recognize loss on inter-spousal transactions. If the price of abolishing the nonrecognition rule for gain is eliminating the non-

105. I.R.C. §§ 2056 & 2523 (1987).

106. I.R.C. § 2513 (1987).

107. I.R.C. § 2032A (1987).

108. According to S. Surrey, P. McDaniel & H. Gutman, Federal Wealth Transfer Taxation 45 (1987). "It is estimated that . . . taxable returns will represent no more than 3/10th of 1 percent of adult deaths each year."

109. *Davis*, 370 U.S. 65.

recognition for loss on inter-spousal transactions, it is hard to say whether affected taxpayers would emerge as net winners or losers.[110]

Similar complexity attends analysis of Code provisions such as § 179.[111] The major effect of marriage under that rule will be to curtail benefits, since married couples are limited to one $10,000 deduction. On the other hand one can easily conceive of a taxpayer A who owns a business that is operating at a loss. To ensure an income, he marries B, a wage earner. Marriage in this case will allow A to make use of the § 179 deduction which would not otherwise have been useful to him.

This discussion, of course, leads to a broader observation. The joint return will frequently allow taxpayers to offset the gains of one with the losses of the other. This is a factor that will tend to offset the marriage tax, narrowly viewed, which results from the addition of one spouse's income to that of the other. The point should not be overstated; in most activities designed to be money-making, taxpayers (thankfully) operate in the black.

The husband-and-wife-as-one shareholder rule[112] provides corporations with maximum flexibility in securing S Corporation status. On the other hand, the rules can also work against married taxpayers. By reducing the number of "shareholders", the rule has the effect of increasing the likelihood of personal holding company[113] and controlled corporation[114] status, possibly resulting in an extra tax liability.

The grantor trust rules,[115] work only one way — against married taxpayers. If, as has been discussed, a taxpayer is cohabiting with his spouse, a prohibited interest or power in trust property given to the spouse will result in the income being taxed to the grantor.

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110. Reasoned speculation suggests that since many inter-spousal transfers are elective, taxpayers would come out ahead.

111. *See supra* note 57 and accompanying text.

112. I.R.C. § 1361(c) (1987).

113. *See supra* note 54.

114. *See supra* note 55.

115. *See supra* notes 44-48.

Generally speaking, the attribution rules[116] in the stock redemption area have worked against taxpayers since they have produced dividend income instead of capital gain. But it is certainly conceivable that the distributee shareholder is a corporation that prefers dividend income on account of the dividend received deduction.[117] Alternatively, it is possible that the distributee shareholder is an individual who has enough ordinary losses to offset the dividend income. In any event, TRA 86, which repealed the capital gain deduction, substantially diminishes the impact of this provision.

The home-gain exclusion disadvantages married taxpayers.[118] On the other hand, the fringe benefit rules allow spouses an extensive range of tax free benefits not available to friends (whether live-in or not) of a taxpayer. Additionally, the social security rules[119] and § 1244 favor marriage.

It would be helpful if we could total the nation's marital deductions, § 179 deductions, etc. and weigh the benefits and disadvantages of marriage. Perhaps these assessments are not far from reality. Under the name of TAXSIM, the National Bureau of Economic Research has a bank of tax information compiled from many thousands of returns which might allow such research. Even so, a complete analysis of the tax effect of marriage will be elusive, if only because exclusions such as fringe benefits are, just that, exclusions and no record is currently kept of them.

Though no grand conclusion can be drawn on the net overall tax effect of marriage, perhaps a less sweeping, more tentative observation can be usefully made. The extent to which marriage affects net tax liability of any individual, both positively and negatively, will depend, of course, on the personal economic circumstances of the taxpayer. Consider the couple in which the husband is an airline executive and the wife is successfully self-employed. This couple may well find that an important tax benefit received from marriage is the right to exclude from income the value of free travel offered to

116. *See supra* note 50 and accompanying text.
117. I.R.C. § 243 (1987).
118. *See supra* notes 59 & 60 and accompanying text.
119. *See supra* notes 84 & 85 and accompanying text.

the spouse of an employee.[120] Moreover, for middle class taxpayers like these, the unlimited marital deduction will be helpful in sheltering all tax in the estate of the first to die.[121]

But, at the same time as the taxpayers benefit from these provisions, others will set them back — in this case probably the rate-based marriage penalty,[122] the IRA deduction[123] rule, and the social security inclusion provision,[124] among others. In short, then, many families may well find that the numerous tax rules tied to marriage tend to counteract one another, thereby reducing nonneutralities.

This is not to suggest that there is no cause for concern. The last two decades have witnessed an important economic trend involving families. In 1955 only 60% of families consisted of a working spouse and a stay-at-home spouse. By contrast in 1985 this percentage dropped to 20%.[125] The stay-at-home spouse is going to work. This trend may well be causing a ganging-up of provisions against the modern taxpayer. Table 4,[126] which takes into account the IRA limitations, helps introduce the problem by comparing the tax burden of singles and marrieds at varying income levels and at varying percentage contributions by the spouses. While the relationship between the marriage tax, income level and spousal income split is quite complex, what stands out is the 39.74% marriage penalty where each spouse earns $25,000.

120. I.R.C. § 132 (1987).
121. *Id.* §§ 2056 & 2523 (1987).
122. *See supra* note 10 and accompanying tables.
123. *See supra* notes 41-43 and accompanying text.
124. *See supra* notes 2 & 3 and accompanying text.
125. U.S. DEP'T OF THE CENSUS, BUREAU OF LABOR STATISTICS (July 1986).
126. *See* G. ESENWEIN, *supra* note 10.

Table 4. Marriage Penalties or Bonuses Under H.R. 3838
Percentage by Which Joint Tax Liability Exceeds That of Two Singles
IRA Provisions Not Included

Income Levels	Percentage of Income Earned by Each Spouse: 50/50 Current Law	50/50 H.R. 3838	60/40 Current Law	60/40 H.R. 3838	70/30 Current Law	70/30 H.R. 3838	80/20 Current Law	80/20 H.R. 3838	100/0 Current Law	100/0 H.R. 3838
$20,000	7.90%	16.39%	8.71%	16.39%	3.39%	0%	16.41%	(21.57%)	(31.17%)	(26.92%)
30,000	5.24	6.21	5.05	6.21	.25	6.21	(8.44)	0	(28.41)	(35.93)
40,000	9.94	3.83	8.59	3.83	1.93	(9.65)	(6.22)	(22.47)	(25.90)	(50.25)
50,000	10.89	39.74	11.05	19.93	4.87	4.66	(4.20)	(3.89)	(23.30)	(26.45)
60,000	13.59	18.27	12.90	16.89	6.94	7.50	(2.99)	0	(21.79)	(23.72)
70,000	15.56	8.64	13.88	12.25	8.18	8.83	(1.20)	0	(19.90)	(22.06)

Source: Calculated by CRS. Tax Year 1988. Assumes wage and salary income only and use of the standard deduction. Assumes $2,000 IRA contribution by each spouse of two-earner couples and $2,250 by one-earner couples. Marriage bonuses appear in parentheses.

Table 4 shows structural marriage penalties and bonuses when the IRA provisions of H.R. 3838 are taken into account. The calculations in this table assume that each income earning spouse contributed $2,000 to an IRA. In the case of one-earner married couples the contribution was $2,250. Marriage bonuses are shown in parentheses.

Even more dramatic results are produced by adding variables. If the taxpayers in the above case each have a capital loss in the year in which they marry, the marriage tax penalty (broadly defined) will be significantly higher. This is due, again, to the loss of $3,000 in capital loss offsets by married couples.[127]

This hypothetical, though designed to dramatize the point, is by no means unrealistic. With more two-earner families it is likely that more spouses, if treated as singles, would be able to claim capital loss, § 179, and IRA deductions in their own right. A fair social security inclusion rule will be more important to them because they will be receiving more social security. Also, because they are both wage earners, the spousal exclusion rule for fringe benefits will be less important to them.

Maybe the only firm conclusion on the subject of the marriage tax (broadly defined) is that Congress is quite often not playing fair with married couples when allocating "benefits" to them, particularly when these benefits are limited to those available to single individuals. There are at least two ways to solve this problem. First, Congress could simply provide that couples should get 200% of whatever benefits are available to singles regardless of whether the benefits would have been available to them as singles. Or, if that is felt to be too extravagant, perhaps 150% of the singles' benefits could be allowed on some averaging principle.

The other solution, which is my recommendation, is that Congress should allow benefits to "second" spouses if a showing is made that these spouses would have been entitled to them if they had been single. Thus, for example, one § 179 deduction would be available if one spouse purchased $10,000 of depreciable property and another one if the second spouse was a joint owner in the asset or purchased a different depreciable asset. This latter approach would represent a departure from tax equality and an acceptance, in part, of marriage neutrality, which for the first 35 years of the income tax system was the prevailing policy.[128]

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127. It is true, of course, that under I.R.C. § 1212 (1987) the capital loss will be able to offset ordinary income in subsequent years.

128. *See supra* text between notes 22-23.

The only problem may be dealing with community property; however, the problem is not an overwhelming one. If property owned is community property, then $20,000 of § 179 deductions would be allowed. Taxpayers in common law states would have little to quarrel about; they could achieve the same result by making their spouses co-owners in the business property. No doubt in common law states there would be some extra administrative burden, but this burden should not present a political problem as even now there are some significant differences in the way the tax law affects the two[129] classes of taxpayers.

CONCLUSION

For at least the last five years it has been difficult to open a newspaper (a periodical of general interest) without reading about criticisms of our institutions for failing to adjust to modern family life. Spurring a number of these pieces is the trend towards two-worker families previously mentioned[130] and the related increase in the percentage of working mothers with school-age children,[131] called "the greatest single shift in family life in this century."[132] Areas targeted for reform have included child care delivery, social security[133] and the income tax. Within this last category proposals have been made to increase both the exemption for children and the child care credit.[134]

This article has considered the related problem of the fairness of the income tax to the married couple. To the end of achieving this fairness, the concrete proposal offered should serve as a useful first step. When the empirical work is done, refinements in reform will be possible.

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129. For example, under I.R.C. § 1014 property jointly held by spouses gets a step-up in basis for only one-half the property while for community property the basis in the entire asset is stepped-up.

130. *See supra* note 125 and accompanying text.

131. In 1960, 42.5% of mothers with school-age children worked; by contrast in 1985, 70% worked. U.S. DEP'T OF THE CENSUS, BUREAU OF LABOR STATISTICS (July 1986).

132. *See* NEW CHOICES IN A CHANGING AMERICA, DEMOCRATIC NAT'L COMM. REP. 8 (1986) [hereinafter NEW CHOICES].

133. *See* Reno & Upp, *supra* note 84.

134. *See* NEW CHOICES, *supra* note 134, at 13.