CHANGING THE PRESENT TAX STRUCTURE'S MARRIAGE PENALTIES AND BONUSES TO INCREASE ECONOMIC EFFICIENCY AND EQUITY

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I. INTRODUCTION.

Marriage bonuses and penalties are caused by imposition of a joint rate filing structure on married couples taxed under a progressive tax rate system.[1] The structure produces differences in tax brackets for single and joint filers, as well as differences in the income levels at which credits and deductions are phased out. The structure also adds the second spouse's income to that of the first spouse to determine the tax rate to be applied to the second spouse's first dollar of earned income.[2] While proponents of marriage penalty relief claim such relief is necessary to remove inequities,[3] they often ignore the bonus and penalty system that now penalizes a majority of two income families.[4] In addition, the present tax structure provides economic disincentives that discourage the second spouse in a low income family from seeking paid work.[5] Both inequitable bonuses and penalties and perverse economic incentives would be reduced by replacing the current joint filing system with a separate return tax system that taxes each individual on that individual's income.

For the most part, what commentators claim is a marriage penalty is not a penalty, but rather is a measurement error caused by failing to account for the economic value of a stay-at-home spouse's services. If one recomputes the effective tax burden to reflect this untaxed income, separate returns create no marriage penalties for families of moderate

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[1] I.R.C. § 1 (2004). The current system taxes singles based on one set of tax brackets, and couples on a second set of tax brackets. A couple with a single wage earner normally pays a lower tax on a given family income than an individual, earning the same income. This constitutes a marriage bonus. A couple with two earners each earning half of the family income pays more tax than two spouses would pay were they not married. This constitutes a marriage penalty. *See* CONGRESSIONAL BUDGET OFFICE, FOR BETTER OR FOR WORSE: MARRIAGE AND THE FEDERAL INCOME TAX, (June 1997) [hereinafter CBO STUDY] at 4-6.

[2] The provisions creating bonuses and penalties are listed in Rev. Proc. 2003-85, 2003-4 I.R.B. 1184 [hereinafter Rev Proc. 2003-85]. The provisions are discussed *infra*.

[3] *See, e.g.*, SYLVIA ANN HEWLETT & CORNEL WEST, THE WAR AGAINST PARENTS: WHAT WE CAN DO FOR AMERICA'S BELEAGUERED MOMS AND DADS, (1998).

[4] CBO STUDY, *supra* note 1, at 13, Table 2 and accompanying text. The Jobs Growth Tax Relief Reconciliation Act of 2003, §§ 102, 104, Pub. L. No. 108-27, 117 Stat. 752 [hereinafter Jobs and Growth Relief Act of 2003].

[5] *See* CBO STUDY, *supra* note 1, at 39-40 and Table 10. Far fewer low income families are two income families than high income families because the cost of replacing the second spouse's in-home services is often greater than what the second spouse can earn in the paid labor force.

means.[6] Child care, home cleaning and maintenance, cooking, home schooling, social schedule management, and charitable contributions in kind all represent untaxed income. When a second spouse enters the paid labor force, services produced by the former nonworking spouse must be replaced. Replacement services are either purchased, or produced by engaging in uncompensated work after completion of compensated work to provide those goods and services formerly provided by the nonworking spouse.[7]

Thus, separate filing of income tax by each individual would minimize both marriage penalties and singles penalties. Separate filing would also reduce present disincentives preventing second spouses from entering the paid labor force by taxing the second wage earner in the family at the same low initial rates imposed on the first wage earner instead of applying the higher marginal tax rate to the increase in family income. The shift to a separate tax structure should be accompanied by modification of the phase-out rules that apply to deductions and credits to place the phase-outs on a separate taxpayer basis. These changes would partially offset labor force entry costs incurred by the second spouse when that spouse enters the paid (and taxed) work force. Separate filing would reduce present disincentives for the second spouse to leave home and enter the paid labor force caused by phase out of tax benefits as reported family income subject to tax rises.

The next section describes the mechanical and philosophical sources of present marriage and single bonuses and penalties. The third section identifies where these bonuses and penalties are located in the present tax code. The fourth section identifies who gains and who loses from the current structure of bonuses and penalties. The fifth section discusses the economic efficiency of a separate tax regime as a means of minimizing marriage bonuses and penalties. The paper concludes that once income of couples is properly measured, separate filing both minimizes bonuses and penalties and provides increased incentives for the second spouse of a low income family to enter the paid labor force.

II. WHAT ARE MARRIAGE PENALTIES AND BENEFITS?

The Congressional Budget Office (CBO) defines marriage bonuses and penalties in federal individual income tax as decreases or increases in taxes that some married couples incur because they pay taxes as couples rather than as individuals.[8] All of the different variations on the definition of marriage bonuses and penalties are based on a comparison of what a husband and wife would be paying if their lives were somehow different—they were both single, or one was single and the other a head of household. In

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[6] *See infra*. Changes in credit and deduction phase-outs are also needed to remove present marriage penalties and bonuses. A separate return structure removes most of the marriage penalties inherent in computation of credit and deduction phase-outs by making each taxpayer, in effect, a single taxpayer.

[7] *See infra*. At lower income, inclusion of untaxed income produced by the unemployed spouse in the measure of marriage penalties removes the marriage penalty. At higher incomes, where the family is likely to have significant unearned income from such assets as stocks and real estate holdings, shifting of asset ownership to the lower earning spouse, when added to the value of the stay-at-home spouse's services, generally minimizes any marriage penalty.

[8] CBO STUDY, *supra* note 1, at 6.

every instance, the alternative could be achieved under the present tax system by divorcing.[9]

A. WHY CHANGE THE PRESENT BONUS-PENALTY SYSTEM?

The recent trend has been to increase the present marriage bonuses and to increase singles penalties.[10] Some commentators want to go further and remove all economic disincentives to marriage even if the removal imposes large penalties on single persons, and produces large bonuses to many married persons.[11] Others want to maintain penalties that discourage expansion of two income families.[12] The conflict is between those who want equal treatment—married couples who have equal incomes should pay the same income taxes regardless of the way earnings are divided between spouses—and those who want marriage neutrality—a couple's income tax bill should not depend on their marital status.

The competing goals are inconsistent. The standard justification for joint returns is that married couples function as economic units, which implies that two couples with equal income should pay equal taxes, regardless of how the earning of the incomes is distributed between the spouses in each marriage.[13] Professor Boris I. Bittker has asserted that the choice between marriage neutrality and couples neutrality cannot be made purely on the basis of tax logic. It must consider society's assumptions about the role of marriage and the family and in the end can rest on nothing more precise or permanent than collective social preferences.[14] As a matter of political theory the position is tautological; however, Bittker begs the question of what good public policy should be. Some argue subsidizing marriage is a good idea that provides a financial incentive to remain married and a disincentive for divorce.[15] Some have even argued that imposition of a marriage penalty on anyone (as opposed, presumably, to a singles penalty) "becomes an infringement on the couple's constitutional right to freely practice

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[9] Lawrence Zelenak, *Doing Something About Marriage Penalties: A Guide for the Perplexed*, 54 TAX L. REV. 1, 25 (2000) [hereinafter Zelenak, *Marriage Penalties 2000*].

[10] *See supra* note 4. The new wider 10% and 15% tax brackets for married couples created by Jobs and Growth Relief Act of 2003.

[11] HEWLETT & WEST, *supra* note 3.

[12] *See* Edward J. McCaffery, *The Burdens of Benefits*, 44 VILL. L. REV. 445, 450 (1999) [hereinafter McCaffery, *Burdens of Benefits*]. McCaffery develops an "Ozzie and Harriet" model of a male income producer and a female homemaker, and argues that since 1948 the tax structure was first developed then modified in an effort to perpetuate this social structure. The system, he argues, is designed to reward traditional one-income "core families" and to ignore penalties imposed on two income "non-core families."

[13] Zelenak, *Marriage Penalties 2000*, *supra* note 9, at 17. *See also* Michael J. McIntyre & Oliver Oldman, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 HARV. L. REV. 1573, 1590 (1977).

[14] Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1395-96 (1975), [hereinafter Bittker, *Taxation and the Family*]; *The Income Tax Treatment of Married Couples and Single Persons*, Staff of Joint Comm. On Taxation, 96th Cong., 2d Sess., 26 n. 1 (Comm. Print 1980).

[15] HEWLETT & WEST, *supra* note 3, at 243. The authors are philosophically opposed to a homemaker's penalty, which, they believe, is implicit in separate filing. Zelenak, *Marriage Penalties 2000*, *supra* note 9, at 31, suggests that their argument for marital bonus is designed to further what they consider to be pro-marriage social policy goals, not to reflect ability to pay.

their religion as well as an infringement on equal protection."[16] This extreme position is inconsistent with recent Supreme Court decisions.[17] In addition, there is little evidence that tax rules affect decisions to marry, so it is unlikely that changes in the bonus and penalty calculus will noticeably increase marriage.[18] Thus, the arguments for marriage neutrality on moral, as opposed to equitable or efficiency grounds, seem to be relatively weak.

Complete marital sharing of income was provided by the 1948 "double wide tax brackets."[19] "Double wide brackets" refers to the joint tax brackets that married taxpayers use to compute their income tax liability. The amount of income earned by a married couple taxed at each rate was twice as large as the income of a single taxpayer taxed at that rate.[20] The problem with the 1948 approach was that it eliminated marriage penalties by creating huge marriage bonuses and very large singles penalties.[21] When two people married, their tax liability remained the same only if each earned 50% of the family income. It declined if the spouses had any other distribution of earnings. The assumptions associated with the 1948 view were that income should be taxed to the person who consumes or enjoys it and that spouses share all income equally, independent of the proportions in which it is earned.[22] The idea that married couples should be treated as a unit is inconsistent with the rest of the income tax law, which requires that, with the exception of joint returns, tax liability is imposed on the person who controls income rather than the person who consumes it.[23]

B. THE FLAT TAX SYSTEM ELIMINATES ALL MARRIAGE BONUSES AND PENALTIES.

The inconsistencies of the marriage penalty must be viewed in light of the "penalty-bonus impossibility theorem," which states that under the present progressive U.S. tax structure there will always be marriage penalties and bonuses, singles penalties and bonuses, or both.[24] The origins of the bonus and penalty structure lie with tax rates

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[16] *See* Richard L. Elbert, *Love, God, and Country: Religious Freedom and the Marriage Penalty Tax*, 5 SETON HALL CONST. L. J. 1171, 1227 (1995).
[17] *See, e.g.*, Locke v. Davey, 540 U.S. 712 (2004).
[18] James Alm & Leslie A. Whittington, *Does the Income Tax Affect Marital Decisions*? 48 NAT'L. TAX J. 565 (1995) finds small but statistically significant effect of the income tax on marriage rates; CBO STUDY, *supra* note 1, at 12-14, reviewing the literature; David L. Sjoquist & May Beth Walker, *The Marriage Tax and the Rate and Timing of Marriage*, 48 NAT'L. TAX J. 547 (1995) (finding no tax effect on marriage rates, but also finding that a tax may cause postponement of marriage to the beginning of the next year); Leslie A. Wittington & James Alm, *Til Death Do Us Part; The Effect of Income Taxation on Divorce*, 32 J. HUM. RESOURCES 388 (1997) finds that the marriage penalty has a small, but statistically significant effect on divorce for women.
[19] The Revenue Act of 1948, Pub. L. No. 80-471, Tit. III, pt. I, 62 Stat. 110, 114-116 [hereinafter Revenue Act of 1948].
[20] *Id.*
[21] Zelenak, *Marriage Penalties 2000*, *supra* note *9*, at 27. In 1948 there were no earned income credits, child care credits, or phase-outs. CBO STUDY, *supra* note 1, at 50, concludes that were the same structure reinstituted today, the CBO estimates that only 44 % of the marriage penalties would be eliminated.
[22] *Id.*
[23] *See e.g.* Lucas v. Earl, 281 U.S. 111 (1930).
[24] Zelenak, *Marriage Penalties 2000*, *supra* note *9*, at 6.

that increase as income increases ("progressive tax rates") and with confusion between whether the government wants to tax individual income, family income, or consumption.

One can replace the present income tax system with a flat income tax that reconciles equal treatment with marriage neutrality.[25] If the percentage of income taxed is constant regardless of income, the tax a family pays is the same whether each member of the family is taxed separately or the family's income is taxed as a unit. Such a system can have some progressivity built into it for those with low incomes by including a negative income tax component for all taxpayers in the form of a universal cash grant, or "demogrant," equal to the tax that would otherwise be collected on whatever level of income is deemed to be essential for necessities.[26] The demogrant would be provided to each individual taxpayer regardless of income or marital status, thus providing tax relief for married couples with a single income earner by providing two demogrants to the family unit.[27] The payment is made independent of income earned. The benefit is conferred on all equally in the form of a negative income tax, against which tax obligations are offset (or cash is paid), at lower levels of individual income earned.[28] A demogrant system can come close to maximizing social welfare by balancing the utility grants from redistribution against the disincentive effects of taxation.[29] The price of replacing the present progressive tax system with a flat rate tax and demogrant system is that it eliminates tax progressivity at any but the lowest levels of income. With the exception of the flat tax and demogrant alternative, as long as a progressive tax system is retained, some combination of bonuses and penalties is unavoidable.[30] Those who suggest otherwise, though they generally do not say so, create a system that eliminates marriage penalties by generating marriage bonuses and singles penalties.[31] Whether the United States should replace the progressive tax system with a flat tax system raises many issues that are independent of bonuses and penalties associated with marital status.

If the present progressive tax system is to be kept, then the questions become, 1) how should bonuses and penalties be minimized, 2) how should they be distributed among single taxpayers, couples with unequal incomes or one income, and couples with two relatively equal incomes, and 3) how should incentives to encourage second spouses to work or to discourage two income families be integrated into the structure? The argument that the decision can rest on nothing more precise or permanent than collective social preferences is outdated.[32] Today, the social costs of bonuses and penalties improvidently granted can be identified with reasonable accuracy and changes in the bonus and penalty structure can reduce the magnitude of those costs. In addition, today society seems to have an affinity for two income families not present in the past.[33] From

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[25] *Id.* at 75.
[26] Daniel Shaviro, *The Minimum Wage, the Earned Income Tax Credit, and Optimal Subsidy Policy*, 64 U. CHI. L. REV. 405, 408-9, 462-66 (1997).
[27] Lawrence Zelenak & Kemper Moreland, *Can the Graduated Income Tax Survive Optimal Tax Analysis?* 53 TAX L. REV. 51, 60-62 (1999), [hereinafter Zelenak & Moreland, *Graduated Income Tax*].
[28] Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CAL. L. REV. 1905 (1987).
[29] *Id.*
[30] Zelenak, *Marriage Penalties 2000*, *supra* note 9, at 4.
[31] Elbert, *supra* note 16.
[32] Bittker, *Taxation and the Family*, *supra* note 14, at 1395-96, was written over a quarter century ago.
[33] SUSAN MOLLER OKIN, JUSTICE, GENDER, AND THE FAMILY (1989), has argued for two income families as the norm. The trend seems to be moving in that direction. FLORIS W. WOOD, AN AMERICAN PROFILE –

a policy perspective, making work more attractive for the second spouse by reducing tax disincentives reduces need for state provided services and produces tax revenue that offsets at least some of the costs of removing present tax disincentives to work.

C. WHETHER TO PERMIT JOINT TAXATION IS PART OF THE DEBATE OVER WHETHER THE COUNTRY SHOULD HAVE AN INCOME TAX OR A CONSUMPTION TAX.

The basic principle of income taxation, as opposed to theories of consumption taxation, is that earned income is taxed to the income earner, and income from property is taxed to the property owner.[34] A consumption tax is imposed on whoever consumes goods and services not on the income earner or property owner.[35] The present joint-return structure is a reflection of a consumption tax theory of taxation. Families are taxed on family income as a proxy for taxing family consumption.[36] The joint system has been grafted onto a tax code that is based on control of income, an income tax concept. Professor Alvin Warren frames the debate as a choice between measuring ability to pay by an income tax, which measures the value one receives for the portion of society's output one produces, and a consumption tax, which measures ability to pay by one's current standard of living as measured by consumption.[37] If tax is based on earnings and capacity to authorize expenditures, separate returns are called for, not joint returns.[38]

The consumption tax is imposed on consumption of goods and services, rather than on earned income and, at least in theory, it may be imposed on each member of the family based on that member's consumption and independent of who earned the money that is spent.[39] Zelenak argues that if the focus is on consumption of income, a joint-return system is appropriate; if the focus is on control, as measured by earning of income, separate returns are called for. He concludes that the choice of focus depends on whether consumption or control is a better measure of ability to pay.[40]

The argument for a consumption tax is that an income tax induces a reduction in the price of present consumption relative to saving.[41] This creates a "dead weight loss"

OPINIONS AND BEHAVIORS, 1972-1989, at 544 (Gale Research, 1990), found that in 1945, only 18% of those questioned approved of a wife working. By 1989, 79% approved of a wife working even if husband could support her.

[34] *See generally* HARVEY S. ROSEN, PUBLIC FINANCE, 2002, 440-465 [hereinafter ROSEN, PUBLIC FINANCE]. Property refers to real, personal, and intangible property.

[35] *Id.*

[36] Zelenak, *Marriage Penalties 2000 supra* note 9.

[37] Alvin Warren, *Would a Consumption Tax Be Fairer than an Income Tax?* 89 Yale L.J. 1081, 1121 (1980) [hereinafter Warren, *Fairer Tax*].

[38] The seminal articles on this debate are; Alvin C. Warren, Jr., *Fairness and a Consumption-Type or Cash Flow Personal Income Tax*, 88 Harv. L. Rev. 931 (1975) [hereinafter Warren, *Fairness and a Consumption-Type Tax*]; William D. Andrews, *Fairness and the Personal Income Tax: A Reply to Professor Warren*, 88 Harv. L. Rev. 947 (1975) [hereinafter *Andrews, Fairness and Personal Income Tax*].

[39] Replacing the income tax with a value added tax would shift the tax burden from what is earned to what is spent.

[40] Lawrence Zelenak, *Marriage and the Income Tax*, 67 S. Cal. L. Rev. 339, 354-5 (1994) [hereinafter Zelenak, *Marriage 1994*].

[41] ROSEN, PUBLIC FINANCE, *supra* note 34.

that reduces economic growth. In other words, an income tax leads to over-consumption and inadequate saving compared to the level of saving and investment generated by a consumption tax.[42] Amounts to be saved are taxed and the after tax net is saved under an income tax. The larger pretax amount is saved and not taxed until it is removed from saving and converted into consumption under a consumption tax. Thus, a consumption tax produces more saving and therefore more investment and growth than does an income tax.[43] This is not necessarily good. The increased saving generated by a consumption tax is independent of macroeconomic considerations related to where the economy is in the business cycle. Too much saving can cause reduced consumption and increased unemployment if the economy has idle resources. Conversely, an increase in saving can reduce inflation and expand output if it occurs when the economy is at full employment.[44] In addition, once one recognizes that untaxed leisure or remaining in the home and producing untaxed goods and services are alternatives to being taxed on consumption, the theoretical advantage of the consumption tax over the income tax becomes questionable. There is some empirical evidence that consumption creates a smaller excess burden, and therefore a smaller dead weight loss to society than does the income tax, but the results are tentative at best.[45]

A consumption tax has its own problems. It is imposed on consumption whether the person consuming has earned income or savings to pay for the consumption or has borrowed to pay for consumption.[46] Bankruptcy effectively negates the consumption tax; however, bankruptcy is less effective at denying the tax collector his portion of income tax.[47] Proponents of consumption taxation argue that taxing consumption financed with borrowings is not unreasonable because taxation is tied to lifetime earnings, and, bankruptcy aside, taxing consumption as it is incurred, taxes what is taken from society rather than what is provided to it.[48] The counter argument is that one should tax wealth, which is the power to consume, rather than simply taxing the act of consuming.[49]

Conversion to the consumption tax has major administrative problems related to both collection and enforcement compared to the income tax. It can be difficult to distinguish consumption from investment.[50] For example, one both consumes and invests in a personal residence. A consumption tax would require taxation of the portion of a home, a car, or any other consumer durable that is consumed, just as it would tax a renter or auto lessee on the rent paid. As a practical matter, the measurement problems associated with identifying the value of consumption of such items are severe.[51] In addition, there are severe transition problems associated with converting from an income

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[42] *Id*.
[43] *Id*. The analysis is, however, a partial equilibrium analysis that ignores the effect of changes in savings rates on the general level of society's output and employment.
[44] *See e.g.* PAUL A. SAMUELSON, ECONOMICS, 1970, at 221-233; OLIVER BLANCHARD, MACROECONOMICS, (2000) at 211-216.
[45] Alan J. Auerbach, *Tax Reform, Capital Allocation, Efficiency, and Growth*, in ECONOMIC EFFECTS OF FUNDAMENTAL TAX REFORM (ed. Henry J. Aaron and William G. Gale 1996), at 29.
[46] George K. Yin, *Accommodating the "Low-Income" in a Cash-Flow or Consumed Income Tax World*, 2 FLA. TAX REV. 445, 459-60 (1995) [hereinafter Yin, *Consumed Income 1995*].
[47] Auerbach, *supra* note 45.
[48] *Id*.
[49] Zelenak, *Marriage 1994, supra* note 40, at 357.
[50] Yin, *Consumed Income 1995, supra* note 46.
[51] *Id.* at 490.

tax to a consumption tax.[52] While each approach has its supporters, the general view seems to be that it is hard to predict which system would be better in practice.[53] Zelenak concedes that as between an income and a consumption tax, both are plausible measures of ability to pay.[54]

The choice is between measuring ability to pay by one's share of the society's output and measuring ability to pay by one's standard of living.[55] Only an income tax imposes the tax burden on wealth and the earnings of wealth.[56] Thus far, Congress has concluded that an income tax rather than a consumption tax is the fairer measure of ability to pay because that is what generally has been enacted, though not without consumption tax like features. As long as that conclusion remains unchanged, the question to be answered remains how to minimize distortions created by the presence of marriage and singles bonuses and penalties generated by the income tax structure.[57]

III. WHO INCURS PENALTIES AND WHO RECEIVES BONUSES IN THE CURRENT TAX CODE?

The current joint tax structure scatters bonuses and penalties among both single and married taxpayers in all income brackets.[58] In 1997, the Congressional Budget Office estimated that marriage penalties amounted to $28.8-$42 billion, depending on which of several sets of assumptions the CBO applied as to what those taxpayers would have paid if single.[59] Families with two wage earners with relatively equal incomes generally incurred marriage penalties. Families with a full time homemaker or with two wage earner families who earned very unequal wage incomes generally received marriage bonuses.[60]

A. DIFFERENCES BETWEEN SINGLE AND JOINT TAX BRACKETS.

The Internal Revenue Code (Code) provides four separate schedules: single, joint, married filing separately, and head of household.[61] Single taxpayers without dependents must use the single rate schedule. Married taxpayers must either file a joint return using the joint rate schedule or be taxed at the unfavorable rates of the married filing separately

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[52] *See* Shounak Sakar & George R. Zodrow, *Transitional Issues in Moving to a Direct Consumption Tax*, 46 NAT. TAX. J. 359 (2003). The authors provide suggestions for overcoming the transitional problems associated with a conversion.
[53] ROSEN, PUBLIC FINANCE, *supra* note 34, at 459.
[54] *See* Lawrence Zelenak, *Children and the Income Tax*, 49 TAX L. REV. 349, 358 (1994) [hereinafter Zelenak, *Children*].
[55] Warren, *Fairer Tax, supra* note 37, at 1121. *See also* Warren, *Fairness and a Consumption-Type Tax, supra* note 38; Andrews, *Fairness and Personal Income Tax, supra* note 38.
[56] *Id.*
[57] *Id.*
[58] CBO STUDY, *supra* note 1, at xiv (1997).
[59] *Id.*
[60] *Id.* at xv. Summary Table 2. *See also*, Ann F. Thomas, *Marriage and the Income Tax Yesterday, Today, and Tomorrow: A Primer and Legislative Scorecard*, 16 NYL. SCH. J. HUM. RTS. 1, 9 (1999).
[61] I.R.C. § 1 (2004); Jobs and Growth Relief Act of 2003, *supra* note 4.

rate schedule.[62] Rates on the married filing separately schedule increase to the next tax bracket at one half of the income level at which a married couple filing under the joint rate schedule moves to the next bracket, far more rapidly than do rates on the single rate schedule.[63] Unmarried persons with children or other dependents file as head of household, a classification providing more favorable rates than are available to other unmarried taxpayers.[64] These four different filing categories give rise to the bonuses and penalties.[65]

The joint filer's rate schedules for the new 10% bracket and the 15% bracket are now twice as wide as those for single individuals for 2003 and 2004.[66] For incomes in these ranges, the schedules produce only marriage bonuses. In these 10% and 15% brackets a couple, each of whom earns the same income, pays the same tax as two unmarried persons would pay.[67] In the two lowest brackets couples with unequal earnings always pay less than would two single persons each earning half of what the couple earns.[68]

The joint rates for the 25% bracket are 167% of the width of the single taxpayer bracket. The joint rates for the 28% bracket are 122% of the width of the single taxpayer bracket. The 33% bracket begins at $146,750 for a single taxpayer, and at $178,650 for a joint filer; however, in both instances it ends at $319,100. Both single and joint filers are subject to a tax rate of 35% on incomes in excess of $319,100.[69] As a result, except in the lowest two brackets, the tax rate brackets are less than twice as wide for a couple as for a single taxpayer. If two single taxpayers each earning the same salary and each in the 25% or higher bracket marry, they are taxed more than they were taxed when single. If a taxpayer earning some income marries someone with little or no income, the couple will be taxed less than they were taxed prior to marriage.[70]

B. Differences in the Standard Deduction for Joint Filers and Single Filers.

The standard deduction for unmarried taxpayers is $4,850 while the standard deduction for taxpayers filing jointly is double that amount or $9,700.[71] A non-working single person with no income receives no advantage from the standard deduction; however, if that person marries someone who is working, the joint deduction provides a marriage benefit. Like the double wide 10 and 15% rate brackets for married persons filing jointly, the double wide standard deduction for couples expires at the end of 2010 at which point, the joint filer standard deduction will again be 167% of a single person's

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[62] Rev. Proc. 2003-85, *supra* note 2.
[63] *Id.*
[64] *Id.*
[65] I.R.C. § 6013(a)(b) (2004).
[66] Rev. Proc. 2003-85, *supra* note 2.
[67] *Id.*
[68] *Id.*
[69] *Id.*
[70] *Id.*
[71] Rev. Proc 2003-85, *supra* note 2; Jobs and Growth Relief Act of 2003, *supra* note 4; I.R.C. § 63(c)(2) (2004).

standard deduction.[72] Seventy percent of all taxpayers use the standard deduction.[73] For all such persons the temporary brackets for couples produce marriage bonuses but no penalties. In 2010 the structure will again produce penalties for couples with relatively equal incomes and bonuses for single income couples and couples whose spouses have large income disparities.[74]

C. DIFFERENCES IN PHASE-OUT OF THE PERSONAL EXEMPTION FOR SINGLE AND JOINT FILERS.

The amount of the personal exemption is $3,100 per exemption and does not change based on marital status.[75] Since exemptions are individual and additive, they do not by themselves create either penalties or bonuses that are dependent on marital status. However, the exemptions are phased out at levels that are less than twice as high for couples as for single taxpayers, thus creating marriage penalties and singles bonuses. The phase-out begins at $214,050 and is completed at $336,550 for joint returns. It begins at $142,700 and is completed at $265,200 for unmarried individuals.[76] Thus, the phase-out for joint filers is complete at 127% of the rate single individuals lose all of their exemptions. The personal exemption produces a marriage benefit for an individual earning between $142,701 and $265,200 who marries a relatively low income (or zero income) spouse and takes advantage of the higher phase-out levels applicable to a joint tax return. Conversely, if two single filers, each earning no more than $142,700 marry, and together earn more than 150% of what either earned when single, they incur a marriage penalty.

D. TAXATION OF SOCIAL SECURITY BENEFITS.

There are two separate regimes for taxing social security. The first adds one half of the social security benefits to income if the base amount of income is $32,000 for joint filers and $25,000 for single individuals.[77] In addition, at above $44,000 for joint filers and $34,000 for single filers, up to 85% of social security benefits are taxed.[78] Because the portion that is taxed starts to increase when income for married couples is 129% of income for a single person, the provision creates a bonus for single income couples and a penalty for most two income couples.

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[72] Economic Growth and Tax Relief Reconciliation Act of 2001, P.L. 107-16; Jobs and Growth Relief Act of 2003, *supra* note 4; I.R.C. § 63(c)(2) (2004); Working Families Tax Relief Act of 2004, P.L. 108-311.
[73] CBO **STUDY**, *supra* note 1, at 15 n. 4.
[74] *Supra* note 72.
[75] *Id.*
[76] I.R.C. § 151(d) (2004). *See* I.R.C. § 151(d)(3)(E) and (F) (2004), which provides that the present phase-out for personal exemptions is itself scheduled for elimination beginning in 2006 and will be completely gone in 2010.
[77] I.R.C. § 86 (2004).
[78] I.R.C. § 86(c) (2004).

E. CHILD CARE CREDIT.

I.R.C. § 21 (2004) provides for a credit of up to 35% of $3,000 of child care expenses incurred for one qualifying child or other dependent, 35% of $6,000 of child care expenses incurred for two or more dependents. The credit is subject to a reduction for married or single taxpayers with adjusted gross income of over $15,000 at the rate of 1 percentage point for every $2,000 of adjusted gross income over $15,000 until the credit reaches 20% of the lesser of the maximum amounts or the actual amounts.[79] Thus, the maximum amount of the credit is $1,050 for one child, or $2,100 for two or more children or other dependents when income is $15,000 or less. The minimum amount of the credit is the lower of 20% of actual expenses or 20% of $3,000 for one child, $6,000 for two or more children. The 20% limit applies for single taxpayers and taxpayers filing jointly with adjusted gross income of greater than $43,000 and produces a credit equal to $600 for one dependent, or $1,200 for two or more dependents.[80] In addition, to producing only marriage penalties, the credit is limited to the earnings of the lower income spouse and if the spouse is not working no credit is allowed.[81] The 35% of cost credit rate and higher allowable incomes before the credit starts declining were added by the Jobs and Growth Tax Act of 2003.[82]

F. THE CHILD TAX CREDIT.

Taxpayers who have one or more qualifying children may be entitled to a child tax credit of $1,000 per child for 2004. The child credit is reduced by $50 for each $1,000 by which a single taxpayer's income exceeds $75,000, and by $50 for each $1,000 by which joint filers' income exceeds $110,000.[83] Because the credit is reduced beginning when a joint filer's income is 147% of the single taxpayer's income, it acts as a marriage penalty when marriage pushes the couple's income above the joint filing threshold. The tax credit (less any nonrefundable tax credit to which the taxpayer is entitled) is refundable to taxpayers who have zero or limited income tax liability in an amount equal to 10% of the taxpayer's earned income in excess of $10,750 up to the per child credit amount.[84]

G. EDUCATION CREDITS.

There are two education related credits for higher education, the Hope Scholarship Credit and the Lifetime Learning Credit. The Hope Credit provides a maximum allowable credit of 100% of the first $1,000 of expenses and 50% of the

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[79] I.R.C. § 21(a)(2) (2004).
[80] I.R.C. § 21(c)(1)-(2) (2004)
[81] I.R.C. § 21(b)(C) and §21(d)(1)(B) and (2) (2004). This is subject to two exceptions: Both a spouse who is a student and a spouse who is incapable of caring for himself or herself is treated as though the spouse had income of $250 per month for one child or $500 per month for two or more children.
[82] *Supra* note 4.
[83] I.R.C. § 24(c) (2004).
[84] I.R.C. § 24(d) (2004), Rev. Proc. 2003-85, *supra* note 2.

second $1,000 of expenses up to a maximum of $1,500 per student for each of the first two years of post-secondary education.[85] The Lifetime Learning Credit allows a credit of 20% of qualified tuition expenses paid by the taxpayer for any year the Hope Credit is not claimed up to a maximum allowable credit of $2,000 (the size of the credit doubled in 2003).[86] The Hope Credit is allowed on a per student basis while the lifetime learning credit is allowed on a per taxpayer basis and does not vary based on the number of students in the taxpayer's family.[87] Either the parents or the dependent child can claim the credit.[88] The income limitation for claiming the credits causes them to begin to be phased out at $42,000 and to be completely phased out at $52,000 for single filers. For joint filers the phase-out range is $85,000 to $105,000 in 2003.[89] The band width for joint filers is double the band width for single filers producing marriage bonuses, but not marriage penalties.

H. EARNED INCOME TAX CREDIT.

The earned income tax credit is $2,604 for a couple or single parent with one child and $4300 for two or more children.[90] The credit begins to phase out, regardless of the number of children, at $14,040 for a single filer and at $15,040 for joint filers.[91] It completely phases out at $30,338 for a single filer with one child, at $34,458 for a single filer with two or more children, at $31,338 for a joint filer with one child, and $35,458 for a joint filer with two or more children.[92] The phase-out is almost the same for a joint filer as for a single filer imposing a marriage penalty on almost every family where there is more than one income earner.

IV. .WHO BENEFITS AND WHO IS HARMED UNDER THE PRESENT SYSTEM?

With the exceptions noted above, couples with one income earner receive marriage bonuses, while two income couples with the lower earning spouse earning more than a third of family income usually incur marriage penalties.[93] Further, the phase-out provisions of the child care credit, the earned income credit, and the tax-free receipt of social security impose penalties on low income couples. The other phase-outs affect higher income taxpayers.

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[85] I.R.C. § 25A(b)(1) (2004).
[86] I.R.C. § 25A(a) (2004).
[87] I.R.C. § 25A (2004).
[88] *Id.* Treas. Reg. §1.25A-1(f)(1) (2004) provides that if the parents right to claim the credit is phased out and the student has sufficient tax liability, the student may claim the credit.
[89] Rev. Proc. 2003-85, *supra* note 2.
[90] I.R.C. § 32(b) (2004).
[91] Rev. Proc. 2003-85, *supra* note 2.
[92] *Id.*
[93] CBO STUDY, *supra* note 1.

A. CURRENT BONUSES AND PENALTIES.

Forty-two percent of all couples incur marriage penalties, 51% receive bonuses, and 6% are unaffected.[94] Levels of income are not good indicators of whether a couple receives a bonus or pays a penalty except in the lowest income levels where the minimal level of tax due means that there are few penalties.[95] Couples with incomes between $20,000 and $50,000 are somewhat more likely to receive bonuses than to incur penalties. Fifty-five percent receive bonuses, 44% receive penalties, and 1% are unaffected.[96] For families earning more than $100,000 51% incur penalties averaging $2,640, 49% receive bonuses averaging $2,970.[97]

Distribution of income between spouses is a good indicator of whether a couple will receive a bonus or a penalty. Couples with incomes evenly divided are more likely to incur penalties.[98] Among couples where each spouse earns at least one-third of family income, 90% incurred penalties averaging $1,400 per family for a total of $15 billion in additional taxes. Nearly two-thirds of two-earner couples in which one spouse earns less than one-third of total income still pay penalties totaling over $13 million while one-third receive bonuses equal to $4 billion.[99] In contrast, couples with one earner make up 44 % of all couples and receive 77% of all bonuses. The bonuses are valued at $28 billion. Virtually no single earner family pays a penalty.[100]

A major explanation for why higher income families are likely to pay penalties is that nearly 80% of couples in the over $100,000 range had two earners in 1995.[101] In contrast, only 31% of couples with earnings below $20,000 had two incomes in 1995.[102] The difference between the percentage of two income couples at higher and lower income level couples may be explained by the cost of replacing non-taxed goods and services produced at home with purchased services paid for with after tax dollars. The "stacking effect," which imposes the marginal tax rate of the first spouse on the first dollar earned by the second spouse, compounds the problem.[103] The two factors are more of a deterrent to entering the labor force at lower incomes than at higher incomes because they reduce disposable income from work below the level needed to replace the untaxed production of goods and services produced by the unemployed spouse who remains at home.

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[94] *Id.* Summary Table 1. The data is for 1996.
[95] *Id.* at 31.
[96] CBO STUDY, *supra* note 1, at 30, Table 6.
[97] *Id.*
[98] CBO STUDY, *supra* note 1, at 35.
[99] *Id.*
[100] *Id.*
[101] CBO STUDY, *supra* note 1, at 39. Forty-three percent of couples earning more than $100,000 had two earners in 1969.
[102] *Id.* Twenty-nine percent of couples earning zero to $20,000 had two earners in 1969.
[103] CBO STUDY, *supra* note 1, at 10, Zelenak, *Marriage Penalties 2000*, *supra* note 9, at 63. Zelenak argues that except for limited child care relief the system makes no allowances for expenses incurred by a second spouse who enters the labor force.

B. THE CHANGES MADE IN THE JOBS AND GROWTH TAX ACT OF 2003 BENEFIT PRIMARILY THOSE WITH HIGH INCOMES.

Widening the brackets for joint filers to twice the width of single filers reduces the tax burden or increases the marriage bonus for high income taxpayers far more than it reduces the burden on low income taxpayers.[104] Widening the brackets drops the tax of lower income filers that were formerly taxed in the 15% and 25% brackets to the 10 and 15 % brackets. Many of these could have earned additional income without moving into the next bracket. Taxpayers in above the 25% bracket shift the maximum amount formerly taxed at 15% and 25% to the 10% and 15% brackets, and every dollar shifted down to either of the lowest two brackets is a dollar formerly taxed at the highest bracket. The tax savings caused by the reduction in the amount taxed at the 33% or 35% bracket as the 10% and 15% brackets expanded is far greater than the tax savings caused by reducing the quantity taxed at 25 or 28% because the lower brackets were widened.[105] Expanding tax brackets for joint filers is, therefore, poorly targeted if the goal is to provide tax relief to lower income families. In particular, double wide tax brackets and standard deductions for joint filers twice the size of standard deductions for single filers, would eliminate 44% of the marriage penalties.[106] However, the changes would provide marriage bonuses mainly to couples with incomes above $50,000, and half of the bonuses would go to those already receiving marriage bonuses.[107] The CBO estimates that 83% of the benefit would go to couples with incomes above $50,000.[108]

C. THE EFFECT OF PROPOSED RELIEF TARGETED AT TWO WAGE EARNER COUPLES.

Providing a second earner deduction would reduce marriage penalties incurred by two income families by half without significantly expanding marriage bonuses.[109] It would, however, generate the most benefit for couples with incomes between $50,000 and $100,000. Lower income families generally take advantage of the standard deduction and would therefore receive no benefit from a second income deduction.[110] It would reduce marriage penalties incurred by two income families by half without significantly expanding marriage bonuses at a cost of approximately $9 billion.[111] Properly designed, such relief could also reduce the stacking effect of having a second spouse enter the labor force.

Returning to the 1948 double width brackets for joint filers and letting married couples choose to either file jointly or use the single tax schedule ("optional singles filing") would both result in a revenue loss, similar to the loss from optional singles filing for the same reason. Both approaches reinstitute double width tax brackets for couples at

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[104] *Id*. at 39. High income taxpayers in the study were those earning above $100,000.
[105] Rev. Proc. 2003-85, *supra* note 2.
[106] CBO STUDY, *supra* note 1, at 35.
[107] *Id*. at 50.
[108] *Id.* at 51, n. 1.
[109] *Id.* at 51.
[110] *Id.*
[111] *Id.*

all levels of income. Fifty-one percent of the revenue loss would be in the form of a further reduction for married couples already paying a lower total tax bill as a result of being married than they would pay were they both single.[112] Neither is a well targeted solution unless providing only marriage bonuses and singles penalties is the tax collector's goal.

Mandatory separate filing would require each taxpayer, married or single, to file a separate return and pay tax on the income that filer received. Revenue gains from removing marriage bonuses would more than offset revenue losses resulting from the elimination of marriage penalties under a separate filing tax system and would raise net federal revenues by $4 billion.[113] It would eliminate marriage penalties for families with two equal incomes. The CBO points out that an additional benefit of separate filing is that it would reduce the disincentive for the second spouse to enter the work force.[114]

D. THE EFFECT OF THE EARNED INCOME TAX CREDIT (EITC) RELIEF.

Unlike widening tax brackets for couples, expanding the EITC would provide the majority of relief to those in the $15,000 to $60,000 range.[115] Under the EITC structure a two-earner couple with equal income of $25,000 suffers a marriage penalty of 16.8% of adjusted gross income (AGI), of which 79% is due to the phase-out of the EITC.[116] Forty-one percent of the benefits derived from giving two-earner couples twice the EITC parameters available to single persons would go to families earning under $20,000 and 58% would go to couples with incomes $20,000 to $50,000.[117] Because the relief does not expand benefits for existing beneficiaries, it does not increase marriage bonuses already derived from the EITC.[118]

Making such a change removes major marriage penalties from two income couples earning $20,000 to $60,000 in income by shifting to higher income taxpayers an inequity in the current system that imposes high effective marginal tax rates on low income taxpayers. The present phase-out of benefits imposed as incomes rise above $16,000 is the cause of the high marginal rates.[119] Professor Edward J. McCaffery forecasts that penalties resulting from phase-out of eligibility for the EITC amounts to up to 18% of income at family incomes of $16,000 to $35,000.[120] The relief derived by

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[112] *Id*. at 50.
[113] *Id*. at 54.
[114] *Id.* at 55.
[115] *Id.* at 49 Figure 7 and at 53-54.
[116] *Id*. at 21, Box 5. The Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38, increased the threshold amount at which the phase-out begins by $1,000 in 2004 and $2,000 in 2005 through 2007; however, both the size and extent of the penalty imposed by the phase-out remain approximately the same.
[117] *Id*. at xviii, and summary tbl. 4, at 48. Only 1% would go to couples above $50,000. If one doubled all of the EITC phase-out parameters for married couples, the phase-out would rise to over $62,000 of AGI for one child, and almost $70,000 for two or more children, compared with the current phase-out at $31,338 for one child and $35,458 for two children. *See also* I.R.C. § 32(a) (2004); Rev. Proc 2003-85, *supra* note 4.
[118] CBO STUDY, *supra* note 1, at 21.
[119] Rev Proc. 2003-85, 2003-49 I.R.B. 1184.
[120] Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 UCLA L. REV. 983, 1014-17 (1993) [hereinafter McCaffery, *Gender Biases, 1993]*.

expanding EITC brackets reduces disincentives currently experienced by spouses of low income workers to enter the labor force.[121]

V. A SEPARATE RETURN SYSTEM COUPLED WITH A MARRIAGE NEUTRAL CREDIT SYSTEM WILL REDUCE BOTH THE BONUSES AND THE PENALTIES THE PRESENT TAX SYSTEM IMPOSES.

Unless one is prepared to eliminate the progressive income tax, the questions for policy makers are how should society minimize bonuses and penalties and how should those that remain be allocated. Separate filing for each individual regardless of marital status places each income producer on an individual basis and eliminates marriage as a determinate of taxation.[122] It does not, however, eliminate reported disparities in taxation of a given amount of income that now differentiate a single taxpayer, a couple with taxable income earned by one spouse, and a couple with taxable income earned by both spouses. A separate return system would increase fairness by reducing marriage bonuses and marriage penalties.[123] The CBO reports, "[R]equiring individual filing would, however, cause a large redistribution of tax liabilities from those now incurring penalties to those now receiving bonuses."[124] In addition, by eliminating the "stacking effect," separate filing will encourage second spouses, particularly those in low income families, to enter the labor force.[125] The CBO conclusion is too cursory to accept without further examination. The extent to which a shift from the current joint filing system to a separate filing system would redistribute penalties and bonuses for taxpayers depends on how family income is measured and on the rules that determine how family income from other than earned income is to be allocated between employed and non-employed spouses.[126]

A. CURRENT MEASUREMENTS OF INCOME OVERSTATE THE SIZE OF MARRIAGE PENALTIES.

If each person were to file a separate return reporting his or her own income, marriage would have no tax consequences; however, the general orthodoxy has been that such filing would still impose different tax burdens on couples, depending on the distribution of their income.[127] That orthodoxy ignores untaxed family income produced

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[121] EITC type relief can also be provided by reinstating a second income credit, which is discussed in the next section.
[122] Zelenak, *Marriage 1994, supra* note 40, at 342.
[123] *See* CBO STUDY, *supra* note 1 and the discussion at 54-55. The study indicates that revenue would be increased; however, the result is heavily dependent on the assumptions made as to which spouse is entitled to report unearned income.
[124] *Id*.
[125] CBO STUDY, *supra* note 1, at 54.
[126] Zelenak, *Marriage 1994*, supra note 40, at 382-88,
[127] *See e.g.* Bittker, *Taxation and the Family, supra* note 14, at 1399-1414; Michael J. McIntyre & Oliver Oldman, *supra* note 13, at 1590. *See also*, *Tax Treatment of Single Persons and Married Persons Where Both Spouses Are Working, Hearings Before the House Ways and Means Committee*, 92d Cong. 78-79 (1972) (statement of Edwin S. Cohen, Ass't Treas. Sec'y); STAFF OF JOINT COMM. ON TAX'N, 96TH CONG. THE INCOME TAX TREATMENT OF MARRIED COUPLES AND SINGLE PERSONS, 26 n.1 (Comm. Print 1980).

by "non-working" spouses in the form of goods and services consumed by the family. Because the accounting system does not recognize or tax income produced by the "non-working" spouse, the data on which evaluations such as those of the CBO study are based understate the extent to which even the current tax structure approaches or exceeds marriage neutrality and couples neutrality.[128] These additional goods and services are additions to family income that must be added to reported family income to properly measure marriage penalties and bonuses. Such untaxed income from production of goods and services ("income in kind") must be distinguished from a non-working spouse's production of a successful impression as a spouse in front of the working spouse's employer that leads to a promotion and additional income for the working spouse.[129] The first is added to family income and, because the income is not taxed, reduces true marriage penalties or increases bonuses. It is less clear how to treat the second.[130]

Income in kind produced by a spouse not in the paid labor force should be included in family income for the purpose of comparing the tax burden of single individuals with that of single income and dual income couples. Such an analysis shows that penalties imposed on single income couples decline and often turn into a marriage bonus while the penalties on single persons and dual income couples increase.[131] The problems with measuring the effect relate to quantification of its size and separating income produced by the non-employed spouse in the form of goods and services from income that appears in the form of higher reported payments to the working spouse.[132]

One need only look at tort awards based on "loss of consortium" to appreciate how great a value third parties place on those services.[133] Measurement of such income in kind is further complicated because some would argue that not all of the value of untaxed income is given up when both spouses work a normal work week. This argument does not hold up under examination. Untaxed services produced by two full time working spouses is produced partly at the cost of lost leisure time and partly as a substitute for the services each single person had to provide or purchase for themselves before marriage.[134]

A minimum estimate of the value of a stay-at-home spouse's services of the type that have to be replaced if the spouse enters the labor force can be produced by multiplying the current minimum wage of $5.15 per hour by 40 hours a week. This

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[128] *See e.g.* Zelenak & Moreland, *Graduated Income Tax, supra* note 27, at 60-62.

[129] This produces additional reported income resulting from the spouse's efforts. Whether this is an argument for separate filing, as is suggested in *Note, The Case for Mandatory Separate Filing by Married Persons*, 91 YALE L. J. 363, 375-6 (1981), or whether the income should be taxed first to the husband, then to the wife, Zelenak, *Marriage 1994, supra* note 40, at 356, continues to be debated.

[130] *Id*. Part or all of the additional income received by the working spouse should properly be imputed to the nonworking spouse's efforts for analytical (and probably also for tax reporting) purposes. Since it is not measurable for purposes of computing taxes, it all appears as an unidentified increase in the working spouse's income.

[131] *Id.*.

[132] *See e.g.* Peter Blau, EXCHANGE AND POWER IN SOCIAL LIFE (1964); the sociologists' view of income goes so far as to suggest that a non-working spouse produces services that are provided to the working spouse to pay for support received from the working spouse.

[133] Whittlesey v. Miller, 472 S.W. 2d 665, 668 (Tex. 1978).

[134] STAFF OF THE JOINT COMM. ON TAX'N, 91ST. CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, at 223 (Comm. Print 1970). *See also* testimony of Ass't Treas. Sec'y Edwin S. Cohen, *supra* note 127, at 79.

produces an untaxed annual income of $10,712. The number is undoubtedly low because it ignores the possibility that the stay at home spouse produces higher value services. Spouse-provided services ranging from home schooling to production of high value gourmet meals, if provided for compensation, would generate income far above that produced by employment in a minimum wage position. A family with one working spouse can therefore be thought of as being taxed on an income that is at least $10,712 less than true family income. The marginal tax imposed on even this minimum estimate of income would substantially reduce the average size of marriage penalties (or increase the size of marriage bonuses) for two income families. [135]

The interesting question of how a stay at home spouse's income goes up as the working spouse's income rises has been addressed by Professor Okada.[136] She concludes that the income derived by working males in positions ranging from the Presidency of the United States, to senior officers in a corporation, to successful military officer are, in large measure, the result of efforts of the non-working spouses who perform functions that get the working spouses to their high income positions.[137] This means that the imputed income generated by a wife can be substantial although the problems associated with quantifying their value are considerable.

B. MANDATORY SEPARATE RETURNS FOR EACH TAXPAYER WOULD BE MORE EQUITABLE THAN JOINT FILING.

Mandatory separate filing would require that husband and wife each be taxed on their own income. This would eliminate reported marriage penalties produced by current tax rate schedules applicable to income of two spouses earning equal income. It would also cause single income families to pay higher taxes on reported income than would two single or married persons earning the same family total income divided equally between them. As the analysis in the previous subsection demonstrates, once one adjusts for imputed income produced by a non-working spouse, many of these reported marriage penalties disappear. For lower income families, even $10,712 of income in kind produces a lower tax on total family income (including income in kind) than does a far higher income earned by a single taxpayer under a separate filing regime.[138] For higher single income families (and families with substantial disparity between the incomes of the two spouses), not only is income in kind likely to be greater, but allocation of income from investment to the lower earning spouse moves the income reported by each spouse toward equality.[139]

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[135] Rev. Proc. 2003-85, *supra* note 2. A couple earning as little as $14,300 in reported income would pay an additional $1,607. A couple earning $58,625 would pay an additional $2,678.

[136] Marian J. Okada, A Labor of Love: Stories of the American First Lady, a Corporate Wife, and a Military Wife, 9 CARDOZO WOMEN'S L.J. 527, 2003. *See also*, Joni Hersch, *Taxing Women: Thoughts on a Gendered Economy: Symposium: An Economic Perspective: The Economics of Home Production*, 6 S. CA. REV. L. & WOMEN'S STUD. 421 (1997).

[137] *Id* at 538.

[138] The comparison was made using the tax tables found at Rev. Proc. 2003-85, *supra* note 2, §3.01.

[139] *See e.g.* Zelenak, *Marriage 1994*, *supra* note 40, at 381.

Two classes of complaints are leveled at separate filing, claims that separate filing discriminates against marriage,[140] and assertions that there will be difficulties identifying to whom to assign income.[141] The first problem can be largely dismissed once one correctly identifies and includes untaxed family income. The second problem is explored next.

C. ALTERNATIVE METHODS OF ALLOCATING EARNINGS BETWEEN HUSBAND AND WIFE UNDER A SEPARATE RETURN SYSTEM.

1. OPTIONAL SEPARATE FILING.

Optional separate filing discussed above would provide one means couples could use to arbitrarily identify each spouse's income.[142] It provides married taxpayers the option of selecting to pay taxes under either the current joint rate system or a separate return system, whichever produces the more favorable tax result.[143] The problem with this approach is that it produces the same result as double width tax brackets for couples with equal incomes—no penalties, but massive marriage bonuses and correspondingly large singles penalties. Optional separate filing would allow 64% of savings to go to couples above $50,000 while only 3% would go to couples below $20,000.[144] In addition, proponents of the approach ignore the substantial revenue losses that would have to be made up by increasing the general level of taxes.

2. "DIVORCE AND ALIMONY" ALLOCATIONS OF FAMILY INCOME.

Two commentators have proposed that income be allocated between spouses in the same manner they claim it would be allocated were the couple to divorce. The McIntyres propose equalizing income through a post-nuptial income allocation agreement, which they characterize as similar to alimony in a divorce.[145] The McIntyres claim that in a divorce a couple would divide wage, salary, and investment income equally between spouses. They characterize the proposal as an alternative definition of marriage penalties based on "divorce and alimony." They define marriage penalties as the difference between what a married couple pays in taxes and what they would pay if they exercised their option of obtaining a divorce.[146] In the McIntyre formulation, the

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[140] Hewlett and West, *supra* note 3, at 243.
[141] *See* Zelenak, *Marriage, 1994*, *supra* note 40, at 380-82.
[142] The proposal was introduced in The Marriage Tax Elimination Act, H.R. 2456, 105th Cong. 2 (1997) and S 1314, 105th Cong. 2 (1997). The particular version contained in the draft legislation would have required both spouses to file as single, or to file as joint, but would not permit either to file as head of household.
[143] *Id.*
[144] CBO STUDY, *supra* note 1, xviii, Summary Table 4. The approach, in effect, substantially reduces the amount of progressivity in the tax rate structure for married persons.
[145] Robert S. McIntyre & Michael J. McIntyre, *Fixing the "Marriage Penalty" Problem*, 33 VAL. U.L. REV. 907, 911-12, 929 (1999).
[146] *Id.* Unfortunately for that model, divorce does not normally result in splitting of income between former spouses in the manner they posit. The party receiving alimony and child support does not typically receive one half of the payer's income. In addition, the model does not describe the differential effects on the former spouses' incomes resulting from income earned from subsequent employment of the now single individuals. It presumes a divorce and income splitting of the type specifically declared unlawful by the

higher income ex-spouse pays just enough alimony (deductible by the payer spouse and taxable to the payee spouse) to equalize the post-divorce taxable incomes of the former spouses.[147] This is another means of allocating family income between the two spouses in the same manner as do double wide brackets. If one applies the CBO definition of marriage penalties rather than the McIntyres' definition, their proposal would produce huge marriage subsidies and no marriage penalties.[148] It also produces an allocation of income that is inconsistent with the rules for income allocation between former spouses upon marriage dissolution.[149] It appears that the McIntyres chose their nonstandard definition of a marriage penalty so as to be able to suggest that the cost of eliminating the marriage penalty is modest.

Zelenak rejects the McIntyres' means of identifying income with each taxpayer as counter-factual.[150] Another reason for rejecting the McIntyres' method of identifying who reports income is that it is a definition that provides an allocation of income unreflective of how state law would divide income in the event of a divorce.[151] Contrary to the McIntyres' assertions, most divorce courts do not divide the earning spouse's income equally with the spouse. [152]

Henry E. Smith's "intermediate filing system" offers a more plausible alternative description of how income between the spouse earning income and the non-earning or lower earning spouse would be divided in a divorce.[153] Smith argues that couples could contract to share income in proportion to what each party would accept as receipt or payment in a divorce settlement.[154] In theory the modification removes much of the lack of realism that characterizes McIntyres' equal division approach.

Zelenak claims that there is a problem with the intermediate filing approach resulting from the distinction between income attributable to human capital brought into the marriage by a spouse that would be subject to splitting for tax purposes but not for divorce purposes and other income.[155] Zelenak argues that under divorce settlement principles the parties will be unable to split up human capital if it was earned before

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Supreme Court in Boyter v. Commissioner, 668 F.2d 1382 (4th Cir. 1981). Divorce and remarriage was a sham intended solely to reduce tax and for no other reason.

[147] McIntyre & McIntyre, *supra* note 144.

[148] *Id. See also* Revenue Act of 1948, *supra* note 19. Under this structure, each single taxpayer was taxed on his or her own income. Each married couple filed jointly and was taxed on twice as much income at a given tax rate as was a single filer. (This is referred to as "double wide tax bracket widths.") The system eliminated marriage penalties by substituting huge marriage bonuses for all married couples with unequal incomes. Single taxpayers had to pay higher tax rates to make up the revenue loss and therefore ended up with a marriage penalty equal to the dollar amount of the bonuses.

[149] Carolyn Frantz & Hannoch Dagan, *Properties of Marriage*, 104 COLUM. L. REV. 75, 119-21 (2004).

[150] Zelenak, *Marriage Penalties 2000*, *supra* note 9, at 26.

[151] Frantz & Dagan, *supra* note 148.

[152] *See e.g.* Victoria M. Ho and Jennifer J. Cohen, *An Update on Florida Alimony Case Law*. The distribution of income and property in a divorce varies from state to state. It seldom, however, results in the type of income splitting postulated by the McIntyres. *See* also *Are Alimony Guidelines a Part of Our Future? Part II*, 77 FLA BAR J. 85 (2003) discussing different and conflicting alimony guidelines applied in different states, [hereinafter *Alimony Guideline*].

[153] Henry E. Smith, *Intermediate Filing in Household Taxation*, 72 S. CAL. L. REV. 1945 (1998).

[154] *Id.*

[155] Zelenak, *Marriage Penalties 2000*, *supra* note 9, at 41.

marriage.[156] Zelenak's criticism is too imprecise to generate much concern. The distribution of income derived from human capital when a couple divorces depends on the divorce law of the particular state in which the divorce occurs. Alimony in some states does allocate the income generated from human capital.[157] The more prescient criticism is that because laws regulating divorce settlements differ from state to state, the measure does not provide a consistent indicator of who controls income, but rather reflects how each state's law would assign income in a divorce.[158] Nonetheless, as Zelenak himself recognizes, the difficulties associated with determining to whom income is attributable within the family unit are often severe and that problem affects the attractiveness of his preferred separate filing approach.[159]

Zelenak also criticizes the intermediate filing approach as "intellectually incoherent" because it neither meshes with the theory that income should be taxed to the earner nor with the theory that consumption should be taxed to the consumer.[160] As a method of identifying how much income each spouse would report in a separate filing system the Zelenak criticism is that it could not be accurately implemented. It would be impossible to generate objectively reasonable agreements because couples have too much incentive to negotiate an even division to save taxes, then renegotiate if divorce appears to be looming. Even if couples objectively negotiated an agreed division of the wage earner's income (or incomes) to be applied in the event of divorce, optimism about the low probably of divorce would, in the aggregate, produce income division results inconsistent with ex-post divorce results. Few happily married couples place a realistically high probability on the likelihood of eventual disaffection and divorce.

3. INCOME CAN BE IDENTIFIED TO EACH SPOUSE FOR SEPARATE FILING PURPOSES.

Notwithstanding Zelenak's concerns about separation of income in the divorce context, identification of who earned what income under a separate filing system is manageable.[161] One should allocate earned income to the person who earns it. One can allocate income from property on the basis of one of several alternative methods. Who received the income from each real and personal property asset could be determined by identifying the income to the spouse holding title to the property. Since title to real and personal property must reflect the choice of who is the owner, it replaces the inconsistencies of divorce settlement rules with mechanically workable identification of income with the owning spouse. Allocation of property on the basis of ownership provides families with the opportunity to allocate property income to the lower earning spouse, but only at the cost of the other spouse losing the property in the event of divorce.[162] Alternatively, legislators could, if they chose, allocate property income to the

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[156] *Id*. at 42. Optional separate filing bills of varying sorts have been introduced in S. 1429, 106th Cong. 201 (1999); H.R. 2456, 105th Cong. 2 (1997) and S. 1314, 105th Cong. 2 (1997). Previously optional separate filing had been introduced in the proposed Contract With America Revenue Reconciliation Relief Act, H.R. 1215 104th Cong. 102 (Version 1, Mar. 14, 1995).
[157] *Alimony Guidelines*, *supra* note 152.
[158] *Id.*
[159] *See* Zelenak, *Marriage 1994*, *supra* note 40, at 380-82.
[160] Zelenak, *Marriage Penalties 2000*, *supra* note 9, at 26.
[161] *Id.*
[162] The approach eliminates dishonest allocations but not overly optimistic allocations.

higher-earning spouse or allocate it between the spouses in proportion to earned income regardless of who held title to the property. Income from property could also be allocated equally between the spouses, again regardless of title.[163]

4. DIFFERENCES BETWEEN "COMMUNITY PROPERTY" AND "COMMON LAW" INCOME ALLOCATION FURTHER COMPLICATE SPOUSAL INCOME ALLOCATION.

Identification of separately earned income with spouses differs depending on whether a state is a community property state or a common law state. Community property states allocate half of all income earned by each spouse to the other spouse. Income from separate property is allocated half to husband and half to wife in states following the "Texas Rule," and all to the taxpayer owning the separate property under the "California Rule."[164] If consistency is a consideration, implementing a separate return system would require that the principles of *Poe v. Seaborn*,[165] and *Lucas v. Earl*,[166] treating assignment of income to taxpayers in community property states differently from common law jurisdictions, be overturned. The decision is an interpretation of statute, and there is considerable precedent for a legislative overturning of the decision.[167] A separate return system would have to require that income from all property follow title (or some defined allocation formula) for income tax purposes. Thus, even in community property states, income from property titled in the name of only one spouse would be taxed to that spouse. Similarly, income earned by one spouse would have to be taxed to that spouse even in a community property state to assure interstate parity.[168] The solution to the problem will have to be legislative. Congress would have to require by statute that *Lucas v Earl* become the general rule taxing earned income to the party that earned it and income from property to the property owner.[169] The general view of the commentators is that Congress does have the authority to correct the problem.[170] Once one eliminates the community property issue with respect to allocation of earned and property income, one can deal with how to allocate income earned by property owned by one or both members of the family along the lines outlined above.

D. SEPARATE RETURNS ELIMINATE COSTS IMPOSED ON THE SECOND SPOUSE THAT DISCOURAGE LABOR FORCE PARTICIPATION.

The greater the elasticity of demand for work, the smaller the size of the tax that

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[163] *See* Zelenak, *Marriage 1994, supra* note 40, at 384.
[164] *See* CCH, 2004 U.S. MASTER TAX GUIDE (2003) ¶711, at 231.
[165] 282 U.S. 101 (1930). Income splitting with one's spouse was imposed by operation of law in community property states.
[166] *Id.* at 111.
[167] *See* Zelenak, *Children, supra* note 54 at 365, 382, n. 206. Zelenak points out that the provisions of I.R.C. § 32(c)(2)(B)(i) the earned income credit, I.R.C. § 66(a) addressing spouses who live apart and file separate returns, and I.R.C. § 219(f)(2) contributions to individual retirement accounts, are all inconsistent with the decision.
[168] *See* Zelenak, *Marriage 1994, supra* note 40, at 378. Zelenak believes that the structure can be imposed by statute.
[169] *Supra*, note 166.
[170] Zelenak, *Marriage 1994, supra* note 40, at 378, n. 192.

can be imposed without discouraging entry into the labor force.[171] The object of any tax structure is to raise a given amount of revenue with the least possible disincentive to the income earner to reduce the income producing activity. McCaffery argues that to the extent the second spouse has a greater income elasticity of demand for work than does the first spouse the second spouse should be taxed at a lower rate than the first spouse under optimal tax theory.[172] The joint tax return system does exactly the opposite of what optimal tax theory recommends. It imposes the family marginal tax rate on the first dollar earned by the second spouse to enter the labor market.[173] The preferred approach can be approximated, McCaffery argues, through a separate return system that also provides for a second earner deduction to encourage the second spouse to enter the labor force.[174] He suggests that this can be accomplished through a tax rate structure with refundable credits or with other tax subsidies.[175] The data supports McCaffery's view that, at least at lower incomes, second spouses are discouraged from entering the labor force by tax rate stacking.[176]

Separate returns move in the right direction by removing the stacking effect of the joint tax structure and providing the second spouse with the same starting tax rate as the first spouse to enter the labor force.[177] A convincing case can be made that it is both inequitable and economically inefficient to penalize the second spouse by taxing the first dollar of income at the marginal rate the first spouse pays on the last dollar of income regardless of whether the system produces only marriage bonuses or bonuses and costs.[178] Separate returns would let each spouse begin at the bottom of the rate schedule and would remove the work disincentive effect of stacked taxes on the second spouse to enter the labor force.[179]

McCaffery's argument for a second earner deduction, if implemented, would offset additional expenses the second spouse incurs when that spouse enters the labor force. The goods formerly produced, such as child care, house cleaning, schooling, and whatever else the second spouse to enter the labor force did for the family prior to entering the paid work force, must be purchased with after tax dollars if the second

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[171] F. P. Ramsey, *A Contribution to the Theory of Taxation*, XXIX ECONOMIC JOURNAL, 47 (1927).
[172] McCaffery, *Gender Biases*, 1993, *supra* note 120, at 1037.
[173] I.R.C. § 1 (2004). *See* Rev. Proc. 2003-85, *supra* note 2, Table 1. If the first spouse earns $58,200, the second spouse faces a tax on the first dollar earned of 25% because a joint income of $58,201 moves the family into that bracket. The first spouse to work faces an initial rate of zero and a marginal tax rate of 10% after applying family deductions, exemptions, and credits.
[174] McCaffery, *Gender Biases, 1993, supra* note 120, at 1041. Optimal economic theory and practical politics do not always produce the same results.
[175] *Id*. The possibility of an earned income credit for the second spouse, which would accomplish McCaffery's goal, is discussed *infra*.
[176] CBO STUDY, *supra* note 1, at 10-11
[177] *Id.*
[178] Zelenak, *Children, supra* note 54, at 365.
[179] McCaffery, *Gender Biases, 1993, supra* note 120, at 983, 999. McCaffery also provides an extensive discussion on behavioral incentives created by tax rules and stacking as factors discouraging the second spouse from working. Separate filing and a second income credit would correct the stacking problem inherent in even the 1948 tax structure. Bruce Bartlett, *The Marriage Penalty: Origins, Effect and Solutions*, 80 TAX NOTES 1341, 1344 (Sept. 14, 1998); JANE G. GRAVELLE, THE MARRIAGE PENALTY AND OTHER FAMILY TAX ISSUES; CRS REPORT FOR CONGRESS, 98 TNT 162-11 Aug. 21, 1998, Lexis, TNT File; (arguing for exemption of a substantial part of the second partner's income to correct the problem).

spouse is to work. Few of the expenses are either deductible or subject to a credit.[180] To a large extent, these expenses are marriage penalties.[181] Worse, they provide an incentive to lower income families to seek government aid in preference to seeking a job. The argument for exemption of a part of the second spouse's income from tax has been proposed by a number of commentators as a means of removing this work disincentive.[182]

The arguments for encouraging work by both spouses, at least in a low income family, are that work reduces the state's welfare burden and that subsidizing people to produce goods and services expands real output of society, while subsidizing them not to work does not. To the extent that the tax structure fails to provide incentives to work sufficient to offset the advantage offered by staying at home and producing untaxed income society is the loser. Costs of giving up services produced at home and replacing them with services purchased with after tax dollars act as disincentives for a second spouse to enter the labor force.[183] The problem is compounded by the current Earned Income Tax Credit rules, which phase out family benefits quickly when a second spouse enters the labor force.[184]

Separate returns address only part of the problem. Phase-out of most tax benefits must be disconnected from family income. The separate return structure is consistent with separate standard deductions and separate phase-outs not tied to marital status.[185] Similarly, personal exemption phase-out should not be tied to marital status under a separate return system.[186] The child care credit,[187] child tax credit,[188] and education credits[189] are tied to children. Under a separate return system such credits would still be tied to children. Which parent could claim the credits, how the credits would be computed, and when they would be phased out would have to be reworked to be consistent with separate filing. At higher income levels, a case may still be made that child related tax benefits should continue to be tied to family income rather than individual income. Tying the claim to family income at lower levels of income produces disincentives that discourage the second spouse from entering the paid labor force. Such claims could either be based on family income or could be tied to the income of the higher earning parent. They could not, however, be claimed by both parents unless divided in accordance with some statutory formula.[190] The earned income credit[191]

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[180] The child care credit provided pursuant to I.R.C. § 21 (2004) is an exception.

[181] *See, e.g.* broader tax brackets pursuant to I.R.C. § 1, higher exemption pursuant to I.R.C.§ 151, higher standard deduction, I.R.C. § 63(c), and a variety of other benefits. Strictly speaking, some of these non-deductible expenses would be incurred by an unmarried head of household with a child or dependent; however, the tax code provides a number of tax benefits for unmarried heads of household.

[182] Bartlett, *supra*, note 179, at 1344; Gravelle, *supra* note 179.

[183] McCaffery, *Gender Biases, 1993, supra* note 120, at 1001-2.

[184] Yin, *Consumed Income 1995, supra* note 46. It is within the context of that incentive system that the marriage penalty arises.

[185] I.R.C. §§ 63(c), 68 (2004), *See also* Rev. Proc. 2003-85, *supra* note 2.

[186] I.R.C. § 151(d) (2004). The personal exemption phase-out is scheduled to be eliminated in 2010 pursuant to I.R.C. § 151(d)(3)(E) and (F) (2004).

[187] I.R.C. § 21(a) (2004).

[188] I.R.C. § 24(c) (2004).

[189] I.R.C. § 25A (2004).

[190] The code already contains a number of allocation formulae. For example, I.R.C. § 21(d)(1)(B) (2004), the child care credit, is a function of the income earned by the lower earning spouse.

[191] I.R.C. § 32(b) (2004).

would also have to be redesigned. Since the beneficiary is the wage earner, its redesign might take the form of a second income credit. It could also be a low income credit provided to the first spouse to enter the labor force as long as it was not phased out at a level that discouraged entry into the labor force of the second spouse. McCaffery argues that the low income credit should provide a subsidy to the second spouse to enter the labor force to offset costs of entry.[192] If the twin goals of the system are to encourage second spouses in low income families to work and to minimize marriage penalties, then the credits should favor the second spouse to enter the labor force.[193] Zelenak has argued that the present system is one that works in opposition to itself, and it therefore cannot be an accurate reflection of social preferences.[194] The present system may be the product of either because of an incoherent legislative agenda or be the product of policies implementing Professor McCaffery's argument that the system is intentionally biased in favor of working husbands and stay-at-home wives.[195] In either case the system should be reformed.

VI. CONCLUSION.

The current income tax policies produce excessive marriage bonuses, excessive marriage penalties, and excessive singles penalties, all at the same time. Separate filing, coupled with a revised system of tax credits and deductions, would benefit most of society. Separate filing would reduce marriage bonuses, marriage penalties, and singles penalties. Separate filing would increase social equity and reduce economic disincentives now facing a second spouse who is considering entering the labor force.

If society wants to encourage economic self-sufficiency and minimize the need for direct government assistance to low income couples, a separate filing tax structure and a properly redesigned tax credit structure will help accomplish the goal. It will do so by producing a socially acceptable set of work incentives for low and lower middle income families that the current system lacks. It will also reduce both marriage bonuses and penalties, all at lower net cost to the government than the cost of the current joint rate and welfare systems.

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[192] McCaffery, *Gender Biases, 1993, supra* note 120, at 1041.
[193] *Id*.
[194] Zelenak, *Children, supra* note 54, 349, 368. Zelenak argues that optimal tax theory has a marked propensity to collide with optimal tax theory because the public is not prepared to subsidize a second family member working to such an extent.
[195] McCaffery, *Burdens of Benefits, supra* note 12, at 467, 484-6.