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MARITAL STATUS DISCRIMINATION: A PROBLEM NOT SOLVED BY THE ECONOMIC RECOVERY TAX ACT OF 1981

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Many who have wandered through the maze of the federal income tax laws are aware of the inequities known as the "marriage penalty" and the "singles penalty." The "singles penalty" arose in 1948 when married couples were allowed to consolidate their incomes and use a different rate schedule which was more favorable than that used by a single taxpayer. Under the joint-rate schedule, which is still in effect, income belonging to or earned by one spouse can be attributed to the other spouse. Therefore, when only one spouse has income, the couple will pay less tax than a single taxpayer with the same amount of income. When both spouses have income, the progressive nature of the tax code creates a substantial tax burden or "marriage penalty," since the lower-paid spouse's income is taxed at the marginal rate of the higher-paid spouse. Even the "married filing separate" schedule, established in 1969, results in less favorable rates than the single schedule. The Economic Recovery Tax Act of 1981 partially eliminates the "marriage penalty" but leaves the "singles penalty" intact.

This article will examine the recent changes made by the Economic Recovery Tax Act of 1981 regarding the marriage and singles penalties. Section I of the article discusses the history of marital status taxation leading up to the Economic Recovery Tax Act. Section II describes the current law and its effect upon marital status discrimination. Section III analyzes possible alternatives to the recent legislation that may reduce what can still be viewed as a discriminatory tax policy.

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I. OVERVIEW OF FEDERAL INCOME TAXATION

The tax legislation in the United States, as it has affected marital status, has been erratic and often contradictory. From the beginning, the government has had no consistent policy. In the first individual income tax law in the United States, the Revenue Act of 1913, Congress did not consider marital status as a basis of taxation. The tax unit was the individual and each individual was taxed according to one rate schedule. Husbands and wives had to file separate returns if each had income. The married taxpayer was taxed at the same rate as the single taxpayer, but was allowed an additional exemption for his or her spouse. Even though the tax appeared to be neutral, married persons had an advantage over single persons. In common law states, married persons could, by agreement, lower their marginal tax rate by shifting income to their spouses. This could be accomplished either through trusts, partnerships, employment, or corporate arrangements. In the eight community property states, in which half of the earnings of each spouse belonged to the other and property acquired during the marriage was owned in equal shares, income was automatically shifted to a taxpayer's spouse even though the management and control was usually in the husband. Thus, because of this automatic shifting in income, couples in community property states usually paid less income tax than identical couples in common law states. This shift, whether automatic or by agreement, resulted in married couples paying less tax than single individuals, except in the rare instance where both husband and wife each earned equal amounts of income.

The Revenue Act of 1918 established a joint return for married couples; however, there was no advantage in using the joint return because the same progressive tax rates applied to both single and joint returns. In fact, the joint return increased a married couple's tax liability if both earned income during the tax year. Under the 1918 Act, as under the 1913 Act, married couples had an advantage over single persons, in that they could minimize their total tax burden by shifting income to their spouse and filing separately. Again, couples in community property states did not have to

4. Mess, supra note 1, at 100, suggests numerous plausible reasons the individual taxpayer was chosen as the proper tax unit: 1) the large number of single individuals, 2) the trend toward recognition of separate property rights for women, and 3) a tacit assumption that the term "individual taxpayer" referred only to the male gender.
5. Such shifting arrangements were probably not used frequently, however, because 1) people lacked knowledge of such schemes, 2) such schemes required the aid of a lawyer, and 3) the tax rates were low enough that such schemes were unnecessary.
7. Each state's laws are different, however. Personal service income is generally considered community income. Income from separate property is considered community in some states and not in other states. This aggregation of community income also occurs in other countries, see, e.g., Spain, Argentina, Brazil, and the Dominican Republic. Oldman & Temple, supra note 1, at 585; see also HARVARD LAW SCHOOL INTERNATIONAL PROGRAM IN TAXATION, WORLD TAX SERIES [hereinafter cited as WORLD TAX SERIES].
8. Ch. 18, § 223, 40 Stat. 1074.
9. In unusual circumstances, joint filing could be advantageous. For example, a joint return could increase a generous couple's deductions for charitable contributions by increasing their adjusted gross income and hence raise the deduction ceiling which is determined by a percentage of adjusted gross income. See Bittker, supra note 1, at 1400 n.20.
engage in income-shifting devices, since state law automatically split their income.

Until 1920, the Department of the Treasury had no published policy on the splitting of income by married residents of community property states. It was generally known, however, that the Treasury required all community income to be reported by the husband. In September 1920, Attorney General Palmer issued to the Secretary of the Treasury an opinion which concluded that the community property laws of one state—Texas—were fully effective for federal income tax purposes. Palmer, who advocated that state laws should be recognized in these matters, reasoned that because the husband and wife were legally joint owners of the property under Texas law, they could divide the income from community property and each report half of it to the federal government. In 1921, the Attorney General issued another opinion that reached the same conclusion with respect to all community property states except California. In California, the husband had the complete control of the community interest and could dispose of it as he saw fit during his lifetime without the consent of his wife. The rights and powers of the wife in California were in other respects the same as in the other community property states. The California courts, however, had described the wife's interest as an “expectancy” rather than a “vested” interest. Because of this characterization by the state court, the Attorney General concluded the husband in California should be taxed on all the community property.

Attorney General Palmer's opinions were adopted in 1920 and 1921 Treasury Decisions. The 1921 decision addressed for the first time the issue of federal estate taxes on married couples. The decision adopted a rule similar to the income tax rule that only half of the community property in community property states (other than California) was to be included in the estate of the decedent husband.

It was not long before these rulings were challenged by taxpayers from California. The estate tax ruling was initially challenged in Blum v. Wardell. The federal district court held that in California half of the community property taken by the wife upon the death of the husband is not part of the husband’s estate and, therefore, not subject to federal estate tax. On March 26, 1924, the Treasury acquiesced in this opinion. Interestingly, this acquiescence applied to income taxes as well as estate taxes, and stated

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10. See Community Property, supra note 1, at 354 n.10.
11. Id. at 354.
18. 270 F. 309 (N.D. Cal. 1920), aff'd, 276 F. 226 (9th Cir. 1921), cert. denied, 258 U.S. 617 (1922).
that residents of California should be allowed to split their community property income like residents of other community property states.

While the *Blum* case was being litigated, Congress attempted in the Revenue Act of 1921 to deal with the issues raised by the case. This Act was to have included a uniform rule that would not discriminate between couples in community property and common law states. The rule would have provided: 1) that income received by any married couple in a community property state was includable in the gross income of the spouse who managed and controlled the community property, and 2) that half of the community property taken by the wife on the death of her husband was taxable as part of the estate of the decedent. Even though this provision passed the House and was reported by the Senate Finance Committee, it was dropped in conference and deleted on the Senate floor. Thus, the problem of marital discrimination was left unresolved.

In 1924 the Secretary of the Treasury recommended a similar provision to the House Ways and Means Committee; however, the provision was never adopted. In fact, under the Revenue Act of 1924, Treasury Regulations were implemented, which followed the earlier opinions of Attorney General Palmer and the Treasury Decisions, permitting spouses in all community property states, except California, to split income that was community property. The earlier Treasury Opinion, which acquiesced in the *Blum* case and applied to California law, was withdrawn. However, in 1924, the Attorney General limited his opinion to taxation of community property on the death of the husband, leaving unresolved the issue of whether California allowed income-splitting of community property.

Subsequently, a California taxpayer attempted to resolve the issue in *Robbins v. United States*. In *Robbins*, the taxpayer was forced to include and pay taxes on all income from community property. The taxpayer claimed that the tax was excessive because he should have been permitted to include only half of the income. The Attorney General and the Treasury Department, both in the district court and the California Supreme Court, asserted that the husband is the absolute owner of the property under California state law. The district court ruled against the Government, and held that the husband and wife could report half of the income from the community property and half of the husband's earnings, since the California statutes defining the husband's power of management and control over the community property were substantially the same as those in other community property states. The United States Supreme Court reversed this decision on the grounds that California law, as interpreted by the Supreme Court of California, gave the wife a mere "expectancy" in the community property during the husband's life and that the husband's power of management and control was so extensive as to

23. Treas. Reg. 65 § 213, art. 31 (1924).
26. 5 F.2d 690 (N.D. Cal. 1925), rev'd, 269 U.S. 315 (1926).
render him liable for the tax.  

Until this case, the Treasury had proceeded upon the belief that division of community property income depended upon whether the wife had a vested interest in the property, and not on whether she actually had any control over it. After the *Robbins* decision, the Treasury decided that because the husband usually had significant powers of control and management over community property the government could tax the husband for the total community property income in all community property states. Consequently, the earlier Palmer opinion, which allowed income splitting in community property states was withdrawn, giving the Secretary of the Treasury an opportunity to litigate the tax issue in states other than California.

Subsequent to the *Robbins* decision, the California Civil Code was amended to conform to statutes in other community property states. The new code divided community property between the spouses by providing that the wife's interest was "present, existing and equal" with the husband's interest. Thus, the amended laws of California, as well as the community property laws of Washington, Arizona, Louisiana, and Texas were subjected to general test cases before the United States Supreme Court.

The first test case, *Poe v. Seaborn*, involved a taxpayer from Washington who had income from community property in addition to his salary. The Government argued that the broad powers of the husband over the property made him liable for the tax on the total community income. The Government also argued that taxing the husband and thereby preventing preferred treatment to married couples in community property states would result in uniform income taxation throughout the United States. The court rejected this argument, and stated that the wife is co-owner of the property and entitled to half the husband's income and wages. According to the *Seaborn* Court, the wife has a vested right in the property since the husband's power of disposition is substantially restricted. Specifically, the wife has the power to borrow for community purposes and to encumber the community property. She also has the power to enjoin the collection of the husband's separate debts out of the community property. Furthermore, the community property is not liable for judgments resulting from the husband's torts committed while not carrying on the business of the community. The Supreme Court reached similar conclusions in *United States v. Malcolm*, *Godell v. Koch*, *Bender v. Pfaf*, and *Hopkins v. Bacon*.

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27. *Robbins v. United States*, 269 U.S. 315, 327 (1926). Justice Holmes' opinion indicated Congress has the power to tax community property to the husband. However, Congress, in Section 1212 of the Revenue Act of 1926, stipulated that if the wife has a "vested interest" rather than a mere "expectancy" in the income under state law, she is entitled to include that income on her federal return. Ch. 27, 44 Stat. 9, 130 (1926).


32. 282 U.S. 118 (1930) (involving the laws of Arizona).

33. 282 U.S. 127 (1930) (involving the laws of Louisiana).

34. 282 U.S. 122 (1930) (involving the laws of Texas).
The Seaborn Court distinguished Lucas v. Earl, a case also decided in 1930, in which a husband and wife in California agreed to split the husband's earned income equally between themselves. The distinction made by the Seaborn Court was based on a technical theory of title, that is, the husband's earnings were never exclusively the property of the husband because under Washington law the wife's interest attaches automatically. In Lucas, the income belonged to the husband, and the wife's interest was created by a voluntary assignment of future income. The Supreme Court held earned income could not be shifted among family members by private agreement since the "fruits" could not be "attributed to a different tree from that on which they grew."

The Lucas decision significantly affected how taxpayers in non-community property states assigned their income, and when contrasted with Seaborn and the other cases allowing income splitting in community property states, it sanctioned discrimination between the tax treatment of married couples in community property states and those in common law states. The Lucas and following decisions made it impossible for common law taxpayers to shift earned income to their spouses. The Lucas line of cases did not, however, affect the transfer of unearned income such as dividends, interest, rent, and royalties to a spouse. Investment income could be shifted to a taxpayer with a lower tax liability if the ownership of the underlying property—bank account, stock, patent, etc.—were also transferred.

Following these cases, Congress and the Department of Treasury again attempted to eliminate the differential tax treatment of couples in community property states and those in common law states. One proposal, similar to the one made in the Revenue Act of 1920, required the spouse exercising management and control of community income to pay the income tax. Another proposal required all married couples to file joint returns. A third proposal provided for mandatory joint returns with a special allowance for the earned income of the husband and wife. All of these proposals were rejected. Thus, from 1913 through 1947, community property couples benefitted from splitting of income on their returns.

Initially, there was little resentment perceived toward the community property couples among taxpayers in common law states. This was due mainly to the low taxes levied during those years. The tax rate in 1913 to 1915 was 1% on the first $20,000 of taxable income. From 1919 until 1939, the rates increased somewhat but ranged from 1.5% to 4% on the first $4,000 of income and from 3.2% to 9.17% on income over $4,000 but less than $20,000. During the period of 1939 to 1949, however, rates increased sub-

35. 281 U.S. 111 (1930).
36. Id. at 115.
37. S. REP. NO. 673, 77th Cong., 1st Sess. 9-12, 36 (1941).
39. Id.
substantially, particularly during World War II. For instance, the tax in 1939 on $20,000 was 9.17%; in 1949 it was 30.4%. As taxes began to be felt more, common law states began to adopt community property laws to take advantage of income splitting. By 1948, Michigan, Nebraska, Oklahoma, Oregon, and Pennsylvania had joined the original eight states of Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington in adopting community property laws. Hawaii, Massachusetts, and New York were considering similar steps.

The Revenue Act of 1948 was enacted to prevent more states from adopting community property laws, as well as to diminish the use in common law states of such income splitting devices as trusts, joint tenancies, employment agreements, and family partnerships. The 1948 Act, which adopted a nationwide community property system for federal income tax purposes, was designed to eliminate discrimination against couples in common law states. For the first time in United States tax history, a separate tax rate schedule was instituted for married taxpayers. Married couples were required to aggregate their income and deductions, and in effect, were taxed as two single persons, each reporting half of the couple's aggregate income. As a result, if only the husband were earning income, the couple paid significantly less tax than a single individual with the same amount of taxable income.

The Act caused a tremendous loss of revenue to the federal government. One study indicates that the government has lost in excess of $5.6 billion annually as a result of this change. It did, however, accomplish its purpose, in that common law states stopped adopting community property laws and several states—Michigan, Nebraska, Oklahoma, and Oregon—actually repealed their laws. Hawaii, then a territory, also repealed its laws. The Act also put an end to many of the income-shifting devices being used in common law states. The Act provided a form of geographic equity, since married couples in common law property states were now taxed the same as married couples in community property states. Most important, however, the Act had the effect of changing the basic tax unit for federal taxation

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42. Id.
43. Id.
45. 1947 Neb. Laws ch. 156.
47. 1947 Or. Laws ch. 525.
49. 1945 Hawaii Sess. Laws, 273 § 1. At this time Hawaii was a territory, not a state.
50. See, Bittker, supra note 1, at 1412.
51. Id.
53. For example, a couple having taxable income of $10,000 would pay the same tax as two single taxpayers each having taxable income of $5,000.
from the individual to the married couple. Amazingly, there was no discussion of the higher tax burden placed on single persons or the reasons for reduced rates for married couples. The reduced rate was later justified with reasons such as family responsibilities or the additional expenses of maintaining a household.57

The Revenue Act of 195158 established a third set of rate schedules for "heads of households," who were defined under the Act as single taxpayers who maintained a household in which a dependent relative lived. Under the new rate schedules, heads of households were given approximately half the benefits of income splitting accorded to married couples. The head of household provisions were extended by the Internal Revenue Code of 1954 to include taxpayers who met certain support requirements with respect to their parents, even though the father or mother did not live in the taxpayer's home.59 The 1954 Code also adopted the surviving spouse provision, which extended the full income-splitting benefits enjoyed by married couples to surviving spouses with dependent children.60 The benefits are permitted for two years after the death of the spouse. The rationale given in the legislative history for the special rates for heads of households and surviving spouses was that of family responsibilities; certain support requirements have to be met to qualify for head of household rates and a surviving spouse has to maintain a household where a dependent child resides.61

Single taxpayers received a tax break under the Tax Reform Act of 1969.62 Before the 1969 Act, a single person's tax liability at certain income levels was forty-two percent higher than the income tax of a married couple with the same income.63 The 1969 Act lowered the rates applied to single persons so that the single taxpayer was subjected to no more than a twenty percent differential between his or her tax liability and that of a married couple with the same taxable income. The existing single person's tax rate schedule became the new "married filing separately" rate schedule, a fourth rate schedule. This schedule allowed married couples, both of whom earned substantial income, to avoid the progressive impact of consolidating their incomes. Nevertheless, when the income of the two spouses approached equal amounts, the rate of tax on their income, whether they filed jointly or separately, was heavier than if the couple had chosen not to marry. Thus, two income-producing persons sharing the same household increased their tax burden by marrying.

The burden on single persons and married couples resulted in a number of judicial challenges to the tax code. In 1965 a single taxpayer brought suit

57. See Bittker, supra note 1, at 1416-17.
58. Ch. 521 § 301, 65 Stat. 480.
60. I.R.C. § 2.
63. JOINT COMMITTEE ON TAXATION, 96TH CONG., 2D SESS., REPORT ON THE INCOME TAX TREATMENT OF MARRIED COUPLES AND SINGLE PERSONS 23 (1980) [hereinafter cited as JOINT COMMITTEE].
in *Kellens v. Commissioner*,

charging the tax law under the fifth, ninth, fourteenth, and sixteenth amendments as well as under article I section 2 clause 3 and article I section 9 clause 4 of the United States Constitution. The taxpayer's claim with respect to the ninth and sixteenth amendments and first article of the Constitution was that 1) the amount of tax paid by her was in excess of that which would be payable if joint return rates were applied to her income, 2) the tax paid was not an income tax, and 3) the tax paid was not a tax which was apportioned among the states. The fifth and fourteenth amendment "equal protection" claims were based on the fact that Congress had no rational basis for the distinction drawn between married and single persons for purposes of the applicable rates of tax. All of the taxpayer's claims were denied by the Tax Court, which devoted most of its opinion to the taxpayer's fourteenth amendment argument. The court held that the joint tax schedule was necessary to insure geographic uniformity and to forestall the trend by state governments to adopt community property laws.

In addition, the court noted that conceivably Congress could have believed that married persons generally have greater financial burdens than single persons.

Several married couples brought suit in *Johnson v. United States*,

challenging the tax law under the first, fourth, fifth, ninth and tenth amendments to the United States Constitution. The taxpayers' main argument was that the due process clause of the fifth amendment had been violated in the following four respects:

1. the due process clause of the fifth amendment forbids tax rate differentiation by which the tax on the income of one spouse is measured in part by the income of the other spouse;
2. the due process clause of the fifth amendment forbids gendered-based tax rate differentiation that results in a greater burden on married female workers than is imposed upon married male workers;
3. the due process clause of the fifth amendment forbids marital classification by which higher tax rates are imposed on the taxable income of a married person (whose spouse has significant income) than are imposed on the same taxable income of an unmarried person; and
4. the due process clause of the fifth amendment forbids classification by which higher tax rates are imposed on the taxable income of a married person who lives with her spouse than are imposed on the taxable income of one who does not.

The taxpayers asserted that the classifications under the tax code penalized them for asserting their fundamental right to marry and interfered with their fundamental right of privacy and association, as protected by the first,

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65. 58 T.C. at 559.
66. *Id.*
68. 422 F. Supp. at 962-63.
fourth, fifth, ninth and tenth amendments. In addition, the taxpayers claimed the “free exercise” clause of the first amendment was violated because that clause prohibits the imposition of higher tax rates on those who practice their religious beliefs in regard to marriage.

The Johnson court held there was no due process violation under the taxpayers' first claim since federal law contained no compulsory income aggregation provision.69 Each taxpayer may make the individual choice to file a separate return and avoid “attribution of income.” As to the second due process argument, the court held the federal tax schedules at issue, married filing separately, cannot be said to burden all women, if indeed any are so burdened.70 According to the court, these schedules avoid any type of assumption about the economic status of men and women and therefore there is no basis for holding that women and men are treated differently.71 As to the third and fourth claims, the court recognized the fundamental nature of marriage and freedom to marry under the Constitution, but held that the marriage penalty strictly construed does not create such a severe marriage discrimination that it amounts to a prohibition.72 The court emphasized that the tax rate schedules are not always a disadvantage to those who are married. Congress' longstanding policy that married couples with equal aggregate incomes should pay equal taxes regardless of differences in the contributions of each spouse to the total also influenced the court. Equal tax treatment of the marriage unit, the taxable entity since 1948, was recognized as a legitimate legislative objective. The Johnson court concluded that the government has a compelling interest which justifies the burden upon marriage.73 As to the taxpayers' last argument—infraction upon the right to freely exercise their religious beliefs as to marriage—the court held there is no impermissible restriction on that right.74 According to the court, the fact that some married persons may pay more taxes due to their peculiar economic circumstances does not render a general taxing statute a regulation of religious beliefs. In conclusion, the court asserted that even if it agreed that the Code provisions under attack burden the taxpayer's free exercise of his religion, the government has a sufficiently substantial interest in raising revenue and in equalizing the tax burden between single and married taxpayers to justify any incidental burden on the taxpayer.75

The Johnson case was followed in Mapes v. United States,76 which recognized that marriage is a fundamental right; but, unlike Johnson, Mapes held that strict scrutiny of the marriage penalty was unnecessary. The appropriate test was one of “minimum rationality.”77 The tax system met this test because it merely discourages rather than proscribes marriage.78 As in John-

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69. Id. at 967-68.
70. Id. at 968.
71. Id. at 969.
72. Id. at 970-73.
73. Id. at 973.
74. Id. at 975.
75. Id.
77. 576 F.2d at 901.
78. Id.
son, the court found no gender-based discrimination. As these cases illustrate, taxpayers' judicial attempts to alleviate the marriage penalty and singles penalty have failed.\(^79\)


Under the Economic Recovery Tax Act of 1981, there are five rate schedules: the joint schedule,\(^80\) the heads of households schedule,\(^81\) the singles schedule,\(^82\) the married filing separately schedule,\(^83\) and the estates and trusts schedule.\(^84\) The 1981 Act did not change the following advantages enjoyed under previous law: 1) married couples that file jointly receive a tax advantage from income splitting when their incomes are unevenly distributed; 2) the tax liability of the head of household is more than the tax liability of a married couple, even if their income and family expenses are identical;\(^85\) 3) at all income levels, the single person bears a heavier tax burden than the head of household or married couple filing jointly with the same amount of income;\(^86\) and 4) the married couple electing to file separately is taxed more severely than if that couple were allowed to elect to file under the singles' rates.

The Economic Recovery Tax Act establishes a new rate schedule for trusts and estates that is even less favorable than the rates of married persons filing separately. The big change brought about by the Economic Recovery Tax Act, however, is the provision that allows a married couple with two incomes to deduct from gross income an amount equal to a percentage of the lower-paid spouse's earned income.\(^87\) During 1982 the percentage is five percent. The percentage increases in future tax years to ten percent. In no year, however, may the percentage be applied to more than $30,000 of the

\(^79\) Married couples have also attempted to avoid the marriage tax penalty by divorcing at the end of the tax year, filing as single persons and remarrying at the beginning of the next year. In order to deny tax effect to these "sham divorces," the IRS issued Rev. Rul. 76-255, 1976-2, C.B. 40. The validity of this ruling was addressed in Boyter v. Commissioner, 74 T.C. 989 (1980), in which the Tax Court refused to recognize a Haitian divorce obtained by a married couple living in Maryland at the end of the tax year. The Tax Court supported its holding with a 1945 Supreme Court case, Williams v. North Carolina, 325 U.S. 226 (1945), which declared that the domicile of at least one spouse is a prerequisite to recognition by all other states of a divorce decree under the full faith and credit clause of the United States Constitution.

The Boyter decision left unresolved the issue of whether a divorce decree that is valid under state law should be disregarded for federal income tax purposes pursuant to Rev. Rul. 76-255. Because there are substantial non-tax consequences associated with a valid divorce, it is arguable that the Revenue Ruling may not be given effect. For example, if one spouse should die during the time interval of nonmarriage, life insurance and other insurance coverage may lapse, joint ownership of property may terminate, and a spouse's intestate interest could end. Because of these adverse state law consequences, courts may decide not to give Rev. Rul. 76-255 effect.


\(^81\) I.R.C. § 1(b).

\(^82\) Id. at § 1(c).

\(^83\) Id. at § 1(d).

\(^84\) Id. at § 1(e).

\(^85\) The head of household still pays taxes at rates between those of single persons and those filing jointly.

\(^86\) In no case, however, will a single person pay more than 20% of the amount paid by a married couple with the same income.

\(^87\) I.R.C. § 221 (as amended by Section 103 of the Economic Recovery Tax Act).
lower-paid spouse's income. Thus, the maximum deduction would be $1,500 for tax years beginning in 1982 and $3,000 for 1983 and thereafter. This new provision will cost the federal government an estimated $419 million in 1982, $4.4 billion in 1983, $9.1 billion in 1984, $11 billion in 1985, and $12.6 billion in 1986.88

Congress considered a number of alternative proposals for eliminating the marriage penalty, but chose to follow the recommendations made in an earlier Senate Finance Committee bill and adopted the deduction proposal. That Committee decided the deduction was the simplest way to alleviate the marriage penalty. The Committee Report referred to recent studies showing that high marginal tax rates on the income of a second earner adversely affected that earner's decision to seek employment. In addition, the Committee noted that two-earner couples may be less able to pay their income tax than one-earner couples with the same amount of income. The Committee cited the employment-related expenses, such as clothing and transportation, of two-earner couples and the fact that such couples have less free time for family chores and child care.

The two-earner deduction is calculated like employment-related deductions in arriving at adjusted gross income. First, the taxpayer determines the "qualified earned income" amount, which consists of "earned income" less specified allowable deductions. Then, the appropriate percentage (five percent in 1982 and ten percent thereafter) of that amount is deducted from gross income to arrive at adjusted gross income.

The definition of earned income under the Economic Recovery Tax Act coincides with the definition found in section 401(c)(2) of the Code (dealing with the earned income credit) and section 911(d)(2) of the Code (dealing with income from sources outside the United States). Thus, earned income includes wages, salaries, tips, and anything else of value (money, goods, or services) received for personal services—regardless of whether the amount is taxable. In addition, it includes net earnings from self-employment. Under the new Act, as under the earned income credit, earned income must be computed without regard to any community property laws. Therefore, earned income must be attributed to the spouse who ren-
dered the services for which the income is received. In the case of a person employed by a corporation, earned income does not include any distributions from earnings and profits unless the distributions constitute reasonable compensation for services actually rendered.\textsuperscript{104} In the case of a person engaged in a trade or business (other than in corporate form) in which both personal services and capital are material income-producing factors, earned income is a reasonable amount for services actually rendered.\textsuperscript{105} In such a case, however, a person may not have earned income in excess of thirty percent of his share of net profits from the trade or business.\textsuperscript{106} Earned income does not include interest, dividends, estate and trust distributions, or capital gains and losses, and most rents will not qualify as earned income, except where the owner of the property renders services to occupants or aids materially in the production of farm products grown on rented land.\textsuperscript{107}

The Act specifically provides that earned income will not cover amounts not includable in gross income,\textsuperscript{108} since those amounts will not result in a work disincentive. Thus, social security benefits, veterans benefits, tax exempt interest, and other exempt income do not enter into the calculation. Similarly, pensions,\textsuperscript{109} annuities,\textsuperscript{110} individual retirement plan distribution,\textsuperscript{111} and deferred compensation\textsuperscript{112} are excluded. Pensions and annuities are excluded from earned income because these amounts are composed largely of investment income that has been accumulated tax-free. This exclusion is necessary because the proposal is intended to benefit individuals currently earning income, and not to create a windfall for those whose work took place in past years.\textsuperscript{113} Distributions from individual retirement plans are excluded so that parity with qualified plans can be maintained.\textsuperscript{114} Other forms of deferred compensation are excluded from the definition of earned income for similar reasons.\textsuperscript{115} Additionally excluded are wages currently exempt from certain social security taxes because an individual is employed by his or her spouse. The wages are excluded because 1) they are exempt from social security tax—thus substantial relief is already provided—and 2) the spouses could shift earned income between themselves and attribute an inaccurate or unreasonable amount of earned income to the second earner.\textsuperscript{116} In general, the exclusions are consistent with the definitions that apply to the earned income credit.

Following the determination of earned income, the allowable deduc-

\textsuperscript{106} \textit{Id}.
\textsuperscript{107} [1982] 1 STAND. FED. TAX REP. (CCH) ¶ 519J.05.
\textsuperscript{110} \textit{Id}.
\textsuperscript{111} I.R.C. § 221(b)(2)(A)(iii) (added by § 103(a) of the Economic Recovery Tax Act).
\textsuperscript{112} I.R.C. § 221(b)(2)(A)(iv) (added by § 103(a) of the Economic Recovery Tax Act). In general, deferred compensation is any amount received after the close of the taxable year following the taxable year in which the services are performed.
\textsuperscript{113} S. REP. NO. 96-940, 96th Cong., 2d Sess. 36 (1980).
\textsuperscript{114} \textit{Id}.
\textsuperscript{115} \textit{Id}.
\textsuperscript{116} \textit{Id}.
tions must be ascertained. In general, the Act allows the deductions in Code section 62(1), (2), (7), (9), (10), and (15). The deductions must be allocable to or chargeable against the earned income of the lower-paid spouse, and include expenses attributable to a trade or business from which the earned income is derived. (This corresponds to the deduction under section 62(1)). If, for example, the gross income from a trade or business includes other than earned income, only the proportional share of the deductions attributable to the earned income from the trade or business can be deducted. Typical trade or business expenses include losses, bad debts, depreciation, and rent. Expenses paid or incurred while performing services as an employee (section 62(2)) are also allowed as deductions under the Act, including travel and transportation expenses, expenses incurred by an outside salesperson, and reimbursed expenses. All other deductible employee business expenses are itemized deductions, and would not reduce the employee's earned income. Consequently, employees may have a possible tax advantage over professionals and others not considered employees if the employee itemizes his or her deductions. Deductions for contributions by a self-employed person to a qualified retirement plan, deductions relating to pension plans of Subchapter S corporations, and deductions for contributions to an individual retirement plan are also permitted (section 62(7), (9), and (10) respectively). Certain deductions are not allowed under the new Act since they do not relate to earned income. These deductions include those relating to long term capital gains (section 62(3)); to losses from the sale or exchange of property (section 62(4)); and to deductions attributable to rents and royalties (section 62(5)). In addition, the moving expense deduction (section 62(8)), while relating directly to earned income, is not allowed. Moving expenses, which are infrequent and usually large, could not be included in the qualified earned income without drastically reducing qualified earned income amount, and, in some instances, eliminating it altogether. It is also possible that certain section 62 deductions specifically allowed under the earned income provision could be large and infrequent, causing distortion of the amount. An example of this is an educational expense to maintain and improve the taxpayer's job, this is a section 62(1) deduction for professionals and the self-employed. Such a deduction, along with the deduction for meals and lodging "while away from home," could substantially reduce the earned income amount. In such a case the marital deduction provision would not be fully effective in reducing the marriage penalty.

The Act specifies that no deduction is allowed if either spouse claims on the joint return the benefits of Code section 911 (relating to income earned by individuals outside the United States), or Code section 931 (relating to income from sources within possessions of the United States). Couples bene-

118. I.R.C. § 62(2).
119. In certain cases, as, for example, where there are educational expenses, this treatment could significantly benefit the employee.
120. This combination of educational expense deductions and deductions for meals and lodging could occur when an employee takes a leave of absence from his or her job to maintain and improve job skills.
fiting from these provisions are excluded from the new deductions because substantial relief is provided elsewhere in the Economic Recovery Tax Act for income earned abroad and because coordinating the new deduction with these provisions would be too complicated.121 This provision is consistent with the eligibility rules for the earned income credit, which does not apply to situations in which Code sections 911 and 931 are involved.

Although the new provision may be conceptually simple, calculating the deduction is a complicated matter, as the above discussion illustrates, and will undoubtedly present the IRS with administrative problems. One of the most difficult problems will arise when a taxpayer has disability income or unemployment compensation. The relationship between the earned income deduction and Code section 105 (dealing with amounts received under accident and health plans), and Code section 85, (dealing with unemployment compensation), is extremely complex. Under section 105 of the Code, a disability income exclusion of up to $5,200 annually is available to certain disabled, retired taxpayers under the age of sixty-five. The exclusion phases out on a dollar-for-dollar basis as adjusted gross income exceeds $15,000. This adjusted gross income limit is calculated without regard to the earned income deduction (which is usually a deduction to arrive at adjusted gross income).122 The deduction is then computed, excluding from earned income the amount of the disability income. Similarly, under section 85, unemployment compensation is included in income once the adjusted gross income figure of $20,000 is reached. Thus, a taxpayer includes unemployment compensation in income without regard to the earned income deduction.123 It is possible that the calculations may pose an administrative problem. The problem may not be too significant, however, because only a small percentage of taxpayers have either unemployment compensation or disability income.

A greater administrative problem may arise when taxpayers enter into employment, partnership, and corporate agreements to shift income to the lower-paid spouse. These agreements will give rise to all of the problems with assignment of income that the IRS had before the 1948 Act.124 The abuse from such agreements may be minimized, however, because earned income does not include wages exempt from social security paid to one spouse who is employed by the other spouse. If this social security exemption does not apply, as, for example, when there is a corporate entity, there is a tax advantage to income-splitting. The following table illustrates how the taxes of a husband and wife with a combined income of $60,000 vary as the

121. An individual present in a foreign country for 330 full days in any period of 12 consecutive months may elect to exclude foreign earned income attributable to the period of foreign residence or presence at an annual rate of $75,000 for taxable years beginning on or after January 1, 1982. This amount is increased $5,000 a year over the next four years to $95,000. Thus, at the end of the phase-in period a taxpayer will be able to exclude up to $95,000. In the case of a married couple, the exemption is computed separately for each qualifying individual. See CONFERENCE REPORT, supra note 88, at 203.
122. Section 103(c) of the Economic Recovery Tax Act.
123. Id.
124. See Community Property, supra note 1.
income of each spouse varies. (The table assumes that the deduction is fully effective).

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* An extra exemption is allowed here because one spouse is a dependent.

As evidenced in the table, a couple earning $60,000 can save $1,140 in taxes by entering into a valid income-splitting arrangement.

Couples in community property states are likely to argue that their earned income is automatically split with the other spouse, and will cite *Poe v. Seaborn* to defend their position. Undoubtedly, the taxpayers will lose in any court challenge because it is clear that Congress has the power to disregard state law for federal tax purposes.\(^{125}\)

Although administrative problems may arise under the new deduction provision, the more significant problem is one of equity. As the above table illustrates, the new tax structure is not horizontally equitable, whereby taxpayers who are equally situated are taxed equally. Under our tax system this has been interpreted to mean that the tax of a married couple does not differ when the proportion of income contributed by each spouse differs—as long as the couple has the same combined amount of income. Because married couples pool their income and spend as a unit, they, according to this theory, should be taxed on aggregate income. Under the new tax structure the married couple's tax changes depending on the earned income of the lower-paid spouse.

The purpose of this change in policy seems to be that of economic efficiency. According to this principle, the tax system should encourage the full utilization of human resources in the work force. Thus, the tax rates should be lowest on persons whose work effort is most responsive to lower taxes. Because taxing the lower-paid spouse at the marginal rate of the higher-paid spouse can adversely affect the lower-paid spouse's decision to work—at least in the low and medium income tax brackets—reducing the rate by providing a deduction alleviates the disincentive. The new provision, however, only removes the disincentive where Congress felt the disincentive had the greatest impact—when the lower paid spouse's income is less than $30,000. The earned income deduction does not actually encourage work by the non-working spouse. As the table above illustrates, if a spouse decides to work,

\(^{125}\) Congress has disregarded community property law in the Code before. See, e.g., I.R.C. § 402(e).
the $1,000 extra dependency exemption will be lost, increasing the tax liabili-
y of the couple. In addition, social security taxes and employment-related
expenses (transportation, clothing, household chores, and possible child
care)\textsuperscript{126} are incurred—all of which would most likely exceed the earned in-
come deduction.

Congress apparently felt that the earned income deduction should vary
depending on the lower-paid spouse’s salary. While it is clear that child care
and household expenses remain relatively constant for all those who work
and have children, it is possible that the food, clothing, and transportation
expenses would vary in relation to the salary level. Thus, there is some ra-
nationale for the way the deduction is established. Yet, the tax savings from
the deduction depends on the combined income of the couple, not on the
earnings of the lower-paid spouse. Thus, a spouse earning $5,000 in 1984
obtains a $60 tax benefit when the other spouse earns $5,000, but a tax bene-
fit of $210 when the other spouse earns $65,000.\textsuperscript{127} The difference is due to
the fact that the value of a deduction increases as the income level of the
taxpayer increases. The discriminatory effect of the deduction is reduced
somewhat because the Economic Recovery Tax Act reduces the top tax rates
from seventy percent to fifty percent. However, the deduction is inequitable
to those in the lower income brackets where the tax benefit should arguably
be higher because the needs of the family are likely to be greater.

The earned income deduction was not enacted to discourage couples
from “living in sin” because if that had been its purpose, there would be no
$30,000 limit. As it stands now, the marriage penalty continues and be-
comes more severe at the higher maximum marginal tax rates and when the
separate incomes of the spouses are more nearly equal. The following table,
which assumes the separate incomes of the spouses are equal and that the
earned income deduction is fully effective, illustrates this.

\begin{tabular}{|c|c|c|c|c|c|c|c|}
\hline
Lower-paid & Higher-paid & E.I. & Personal & Taxable & Tax & Tax \nspouse & spouse & deduction & Exemption & Income & Bracket & Benefit \\
\hline
5,000 & 5,000 & 500 & 2,000 & 7,500 & 12\% \times 500 & $60 \\
5,000 & 15,000 & 500 & 2,000 & 17,500 & 18\% \times 500 & $90 \\
5,000 & 25,000 & 500 & 2,000 & 27,500 & 25\% \times 500 & $125 \\
5,000 & 35,000 & 500 & 2,000 & 37,500 & 33\% \times 500 & $165 \\
5,000 & 45,000 & 500 & 2,000 & 47,500 & 38\% \times 500 & $190 \\
5,000 & 55,000 & 500 & 2,000 & 57,500 & 38\% \times 500 & $190 \\
5,000 & 65,000 & 500 & 2,000 & 67,500 & 42\% \times 500 & $210 \\
\hline
\end{tabular}

\textsuperscript{126} Under the new law, the maximum child care credit is $2,400 for one dependent and
$4,800 for two or more dependents. The credit is 30\% of employment-related expenses of tax-

\textsuperscript{127} The following are examples of the differing tax benefits under the new E.I. deduction.

\textsuperscript{127} The following are examples of the differing tax benefits under the new E.I. deduction.

\textsuperscript{127} See \textit{CONFERENCE REPORT, supra note 88, at 201.}
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* PE = personal exemptions of $2,000

Column H above indicates that if the taxpayers were divorced they could save considerable taxes. Column I indicates that married taxpayers filing separately end up paying significantly more tax than if they had filed jointly. Therefore, the couple pays significantly more tax than if they had filed as two singles. There still may be circumstances, however, when it will be more favorable for a married couple to file separately, as for example, when one spouse has a large deductible item.\(^\text{128}\)

It is also interesting to note that for the tax year 1982, the marriage penalty is not eliminated when the lower-paid spouse earns less than $30,000 due to the fact that the deduction is only five percent. The following table indicates the severity of this penalty.

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</table>

* Assume income is split equally between the spouses.

The marriage penalty also continues to exist when both spouses have investment income and when investment income represents a significant portion of the couple's total income. Thus, couples that have investment income will also obtain a tax advantage from "living in sin" or obtaining a

\(^{128}\) The most typical example is when one spouse has a large medical deduction. Because a percentage of adjusted gross income is a floor under the medical expense deduction, a two-earner couple may lower the floor by filing separately.
divorce. Another inequitable problem remaining after the Economic Recovery Act is the continuing discrimination against single taxpayers. At all levels of income the single person pays more tax than a one-earner couple with the same amount of income. The following table indicates the singles penalty at various income levels.

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* Personal exemptions = $2,000/dependency exemption = $1,000.
** Personal exemption = $1,000.

Similarly, two single persons pay more tax than a two-earner married couple with the same amount of income.

To summarize the tax system as it relates to marital status: 1) the tax system is still not marriage neutral because it treats single persons differently from married couples in similar circumstances; 2) the system is not horizontally equitable—married couples with the same combined income but with different separate incomes have different taxes; 3) the marriage penalty still exists; and 4) administrative difficulties may arise in determining the earned income deduction.

Although there are problems with the new deduction provision, a similar provision is being used in a number of foreign countries. In the United Kingdom, Denmark, Finland, Norway, and Switzerland an earned income allowance is given when both spouses receive earned income independently.

129. The following table illustrates a few examples of the effect of the penalty:

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* Assume income is split equally between the spouses.
133. See Chart, top of page 782 supra.
131. It is impossible to have marriage neutrality and horizontal equity unless a proportional tax system is adopted.
Similarly, in Sweden, there is an earned income allowance, but the maximum benefit applies only when the couple has a child under the age of sixteen living in the taxpayer's home.  

III. ALTERNATIVES

A number of different approaches to the marital status discrimination problem have been proposed and several of them are in effect in other countries. The proposals range from eliminating both types of discrimination to only partially eliminating the marriage penalty. Proposals that partially eliminate the penalty include: 1) the credit proposal, 2) the optional use of the singles' schedule by married persons, 3) the optional use of the joint schedule by single persons and heads of households, 4) the split return, and 5) flattening the tax rates. The proposals that completely eliminate marital status discrimination include: 1) the proportional tax system, 2) the one-rate schedule, and 3) the dual-rate schedule.

A. Partial Elimination of Marital Status Discrimination

1. Credit Proposal

One method to reduce the marriage penalty is to grant a tax credit equal to a percentage of the earnings of the lower-paid spouse. Like the earned income deduction, this proposal will not completely eliminate the marriage penalty nor will it change the singles penalty. The credit proposal is as simple as the deduction proposal, and the calculations for determining the earned income amount would be the same. Like the deduction, it abandons the horizontal equity concept that all married couples with equal income should pay the same tax regardless of each spouse's contribution to the couple's total income. The advantage to this proposal is that it is more progressive than a deduction. It avoids the discriminatory effect that a deduction has on lower-income couples. It would not, however, be as effective as a deduction, per dollar of revenue loss, in reducing marginal tax rates in the higher income brackets where high marginal rates present the most serious problems. Under such a proposal the revenue loss would be comparable to the losses under the deduction proposal. Such a proposal has been introduced in Congress; however, it is not a common provision in the tax statutes of other western countries.

2. Optional Use of Singles' Schedules by Married Persons

A method to eliminate the marriage penalty completely is to allow married persons use of the singles' rate for their separate incomes. Unlike the

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132. Information on tax laws of other countries was found in current editions of ARTHUR ANDERSEN & CO., TAX AND TRADE GUIDE; INTERNATIONAL BUREAU OF FISCAL DOCUMENTATION, SUPPLEMENTARY SERVICE TO EUROPEAN TAXATION; and WORLD TAX SERIES, supra note 7.

133. TAX AND TRADE GUIDE, supra note 132, at 79 (Sweden 1978).

134. See JOURNAL OF SMALL BUSINESS, supra note 63, at 59.


136. See Gerzog, supra note 1, at 44; S. 336, 96th Cong., 1st Sess. (1980); H.R. 3609, 96th
deduction or credit provision, this proposal would eliminate entirely the marriage disincentive associated with the marriage penalty and totally equalize the secondary earner’s work incentive to that of his or her spouse. The proposal, however, would not solve the discrimination problem against single persons. In addition, like the deduction or credit provision, it abandons the horizontal equity concept. Perhaps the most troublesome problem with this proposal is that of administrative feasibility. As with the credit and deduction provisions, community property laws would be disregarded to avoid the problem that existed prior to 1948 (the discrimination against couples in common law states). Unlike the credit and deduction provisions, however, investment income would have to be divided, either by an exact method or an allocation method. In addition, all deductions and credits would have to be allocated between the spouses. An arbitrary formula would create new marriage inequities and unfairness vis-a-vis single persons because they would be taxed under an exact method. The exact method, on the other hand, could cause an administrative burden on a couple that normally shares expenses and does not keep exact records as to who earns the income or incurs the expense. Also, there is the problem that community property states automatically divide investment income between the spouses. Advocates of this change claim that allocation problems can be solved by adopting the allocation rules presently existing when married persons file separately.\footnote{Few controversies have developed over the proper allocation of income, deductions, exemptions, and credits between husband and wife under present law because so few couples file separately. See JOINT COMMITTEE, supra note 63, at 38-45.}

3. Optional Use of Joint Schedules By Single Persons and Heads of Households

This proposal would combine the present tax rate schedules into two schedules—the single schedule and the joint schedule. The rate under the two schedules would be the same as under present law. All taxpayers, except dual-income married taxpayers, would use the joint schedule. Dual-income married taxpayers, on the other hand, could opt to use the single tax rate schedule when advantageous to do so (that is, when their incomes are substantially equal). Otherwise, the couple would file under the joint schedule. Frequently, this proposal is accompanied by suggestions for larger dependency exemptions and a deduction or credit for second-earners. Without such a credit or deduction, this proposal would eliminate the discrimination against single persons but not against married persons. In fact, it would exacerbate the marriage penalty because two-earner couples would either have to file jointly and be taxed at unfavorably progressive rates or file as single persons at more discriminatory rates. In addition, this proposal would also pose administrative problems. As in the prior proposal, married persons filing as single persons would need to allocate income, deductions, and credits between themselves. Finally, this proposal would result in large revenue...
losses since single person and heads of households would pay less tax when filing under the joint rate schedules. Small one-earner families would be most adversely affected by this proposal.¹³⁸

4. Split Tax Return

The split tax return proposal¹³⁹ would completely eliminate the singles penalty but only partially eliminate the marriage penalty. A marriage penalty would still exist when the second income source for the married couple is primarily investment income. Under this proposal single persons, heads of households, and married couples file under a single tax rate schedule. All married couples file jointly but if both spouses earn income, they file a “split return.” First, each spouse calculates his or her tax liability on separately earned income. As under the current earned income deduction, business expenses allocable to earnings are deducted. Other deductions, such as interest, medical expenses, moving expenses, and charitable gifts, do not enter the calculation. Second, the tax liability of each spouse is added together. Third, this amount is added to the “net investment tax,” which is the tax on the aggregate investment and earned income of the couple less the tax on the aggregate earned income. The final result is that the singles penalty is entirely eliminated and the marriage penalty is eliminated to the extent the couple has only earned income. The marriage penalty still exists, however, when the couple has investment income. The impact of this proposal on investment income is quite severe because such income is combined with earned income and taxed at higher income rates. At a time when the Economic Recovery Tax Act is being used to emphasize savings and investment,¹⁴⁰ it is not likely that this proposal will be attractive to politicians.

As with the other proposals, this proposal abandons the horizontal equity concept and disregards community property laws. It also poses administrative problems, and is more complex than the current earned income deduction. The proposal is less complicated, however, than when married couples file as single persons because all the personal deductions need not be allocated.¹⁴¹

5. Flattening the Tax Rates

The marriage penalty could be substantially reduced by widening the tax brackets and making our tax structure more proportional. However, the
singles penalty could still exist, depending on what schedules and rates are established under the proposal. One such proposal made prior to the Economic Recovery Tax Act called for the following two rate schedules: 1) married filing jointly—24% of the first $35,200 of taxable income, 45% of taxable income between $35,200 and $45,800, with existing tax rates thereafter; and 2) single taxpayers—24% of the first $23,500 of taxable income, 44% of the taxable income between $23,500 and $34,100, with existing tax rates thereafter. Nonrefundable credits of $800 were proposed for each single person and head of household and $1,600 for each married couple. Under this proposal, the marriage penalty would be virtually eliminated for couples with less than $35,200 of taxable income, and the penalty would be substantially reduced for those with higher incomes. However, the discrimination against single persons would continue. In fact, some single taxpayers would pay greater amounts of tax under this proposal than under the law prior to the change.

The biggest problem with this proposal is one of vertical equity, which is the principle that taxes should be higher on those better able to afford to pay the tax. Flattening the tax rates would distort this principle because higher-income taxpayers frequently have more deductions and tax preference items than lower-income taxpayers. Therefore, higher-income taxpayers could end up paying less than their fair share of the taxes under this proposal.

B. Complete Elimination of Marital Status Discrimination

1. Proportional Tax System

The adoption of a proportional tax structure would eliminate the discrimination based on marital status. It also would be horizontally equitable because all married couples would be taxed at a flat percentage of gross income, adjusted gross income, or taxable income. Such a proposal would not, however, be vertically equitable. The proportionate tax system would necessitate a fundamental change in our traditional tax structure, which is based on the ability to pay. Although it is possible to make this system more progressive by adopting elaborate credit mechanisms based on income, this would complicate the tax system. In addition, it creates the problem of whether the income of a married couple should be combined or separated to determine the credits. If the credits are based on the combined income of the couple, the marriage penalty might be exacerbated. If the credit is based on each couple's taxable income, allocations of income, deductions, and credits are necessary.

2. One-Rate Schedule

Perhaps the most frequently suggested proposal to completely eliminate

142. See Joint Committee, supra note 63, at 61.
143. Id.
144. See Sjostrand, supra note 1, at 424-28.
145. Id.
the marital status discrimination is the adoption of a single-rate schedule. Under this proposal, the individual would be the taxable unit, and each taxpayer would file a return based on one rate schedule that includes that taxpayer's income, deductions, and credits. This proposal would, in effect, reinstate the pre-1948 tax structure without the joint return provisions. As under prior proposals, this proposal would disregard community property laws for tax purposes and each taxpayer would report the income that belonged to him or her. The proposal would create the same administrative problems that arise when taxpayers are allowed to file separately. Investment income, deductions, and credits would have to be allocated. Under this proposal, however, all married taxpayers, not just those with two incomes, would be required to divide and allocate their income. In addition, this proposal would result in a substantial revenue loss, as would several of the prior proposals.146

3. Dual or Two-Rate Schedules

This proposal would combine the present tax rate schedules into two new rate schedules.147 Married taxpayers would file jointly under one tax schedule in which the rate brackets are half as wide as those in the tax schedule for single taxpayers, heads of households, and married persons electing to file separately.148 Under this proposal, both types of discrimination are eliminated. Horizontal equity, however, is not maintained. Married couples who have different combinations of income will pay different taxes. In fact, married couples with equal amounts of income receive the best tax advantage, whereas couples with the greatest difference between their incomes will be in a worse position. Because this proposal more severely affects married couples in which only one spouse works it is often accompanied by suggestions to increase exemptions for the spouse who does not work and for children.

The major problem with the two-rate schedule, as with several of the prior proposals, is that an allocation scheme must be established in order for married couples who opt to file under the singles schedule to be able to divide their income, deductions, and credits. As with most of the proposals, there is no economic incentive to encourage a nonworking spouse to work.

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146. The one-rate schedule has been adopted in Canada, Australia, Pakistan, and Yugoslavia. See WORLD TAX SERIES, supra note 7. In Canada, couples in which spouses earn more than a nominal amount are required to file separate returns. See Oldman & Temple, supra note 1, at 591.

147. See Harmelink & Krause, supra note 1, at 764.

148. An example under our system would be the following:

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Taxable Income</th>
<th>Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singles/H of H/</td>
<td>One-earner married couple</td>
<td>1982</td>
</tr>
<tr>
<td>Two-earner married</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$4,400-6,500</td>
<td>$2,200-3,250</td>
<td>16%</td>
</tr>
<tr>
<td>10,800-12,900</td>
<td>5,400-6,450</td>
<td>22%</td>
</tr>
<tr>
<td>15,000-18,200</td>
<td>7,500-9,100</td>
<td>27%</td>
</tr>
<tr>
<td>18,200-23,500</td>
<td>9,100-11,750</td>
<td>31%</td>
</tr>
<tr>
<td>28,800-34,100</td>
<td>14,400-17,050</td>
<td>40%</td>
</tr>
</tbody>
</table>
The two-rate schedule would not be as administratively burdensome as the one-rate schedule because not all married couples would file separately. However, unlike the one-rate schedule, under the two-rate schedule proposal taxpayers have the option of calculating tax under both schedules to determine which schedule provides the better tax advantage.\textsuperscript{149}

IV. CONCLUSION

The newly enacted earned income deduction does not totally solve the marriage penalty and leaves the singles penalty virtually unchanged. It appears to be a mere stopgap measure aimed at providing tax relief for married couples in which the lower-paid spouse earns less than $30,000. However, the alternatives to the earned income deduction, as shown above, have their own problems. One advantage of the earned income deduction is its administrative manageability. Most of the other proposals (with the exception of the credit proposal) create new complexities in the tax calculation. The credit proposal, like the deduction proposal, will not solve the marriage penalty completely nor will it change the singles penalty. In addition, most of the other proposals have limited results and will solve only one of the penalties, but not both. By flattening the tax rates, the marriage penalty can be partially solved but the singles penalty would become worse. Allowing single persons to file under the joint return will increase the marriage penalty. Additionally, allowing married individuals to file as single persons fails to solve the singles penalty problem. The split return is perhaps the best of the partial elimination approaches; however, it would perpetuate the marriage penalty for couples with investment income. In addition, it is not simple to calculate.

Analysis of the complete elimination proposals indicates that the proportional system alternative is not acceptable because of its fundamental change in the progressivity of the tax rates. Additionally, the single-schedule and dual-schedule proposals pose administrative feasibility problems because income, deductions, credits, and exemptions must be allocated between the spouses.

Despite these problems, many of these proposals have been adopted and successfully used in other countries. The split return and single-schedule alternatives appear to be viable alternatives to remedy the existing penalties on married couples and single persons. Ultimately, however, the decision to eliminate marital status discrimination in the tax code will rest on political considerations.

\textsuperscript{149}. This only occurs, however, when one spouse has a large deduction, such as a medical expense.