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# INTERMEDIATE FILING IN HOUSEHOLD TAXATION

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## I. INTRODUCTION

Over the course of its history, the income tax in the United States has reflected an attempt to maintain progressive rates, avoid marriage and single penalties, and tax married couples with the same total household income equally. However, serving all three traditional goals is impossible, and at least one of them must be sacrificed. To answer this central “trilemma” of household taxation, it has been universally assumed that a progressive rate structure entails weighing the relative merits of two choices: joint filing versus individual filing. This Article will explore and defend a third alternative, which I will call “intermediate filing,” and under which couples would choose a ratio to govern both income tax treatment and division of the broadest range of assets on divorce. Considering this alternative of intermediate filing will allow us to analyze the role that sharing plays in the taxation of married couples and other multitaxpayer groups.

The trilemma is easily illustrated. In his 1972 testimony before the House Ways and Means Committee, Edwin S. Cohen, Assistant Secretary of the Treasury for Tax Policy, offered a widely-cited proof of the existence of the trilemma,<sup>1</sup> which can be summarized as follows. Consider four cases:

Case 1, a single person, *A*, who earns \$20,000.

Case 2, two single persons, *B* and *B'*, who each earn \$10,000.

Case 3, a married couple, in which *C* earns \$20,000 and *C'* earns zero.

Case 4, a married couple, *D* and *D'*, in which each earns \$10,000.

First consider marriage neutrality. If there is to be no penalty on remaining single, *A*, who earns \$20,000 in Case 1, must pay the same tax as *C* who earns the same amount in Case 3 but who is married. Similarly, if a marriage penalty is to be avoided, then the two singles in Case 2, each of whom earn \$10,000, must pay the same total tax as Case 4's married couple, in which each spouse earns \$10,000. Finally, if we want couples with the same total household income to pay the same amount of tax—a concept known as “couples neutrality”—then the couple in Case 3 must pay the same tax as the couple in Case 4.

Thus, the tax in Case 1 must equal that in Case 3, the tax in Case 2 must equal that in Case 4, and the tax in Case 3 must equal that in Case 4. Therefore, the tax in Case 1 must equal that in Case 2; in other words, a single person earning \$20,000 must pay the same level of tax as two single persons each earning \$10,000. But this is impossible under a progressive rate structure. Generally, under progressive rates, a single person making twice as much as each of two other single people must pay a higher level of tax than the other two do collectively. Thus, marriage neutrality, couples neutrality, and progressive rates are incompatible.

This fact has given rise to extensive literature about how to come to grips with this inevitable trade-off.<sup>2</sup> In addition, the example cases above

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1. See *Tax Treatment of Single Persons and Married Persons Where Both Spouses Are Working: Hearings Before the House Comm. on Ways and Means*, 92d Cong. 78-79 (1972) (statement of Edwin S. Cohen, Assistant Secretary for the Tax Policy of the Treasury).

2. See, e.g., MICHAEL J. GRAETZ, *THE DECLINE (AND FALL?) OF THE INCOME TAX* 29-40 (1997) (discussing marriage penalty in terms of societal values); EDWARD J. MCCAFFERY, *TAXING WOMEN* 19-23 (1997) (arguing inter alia for individual filing); Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1396 (1975) [hereinafter Bittker, *Taxation and the Family*] (summarizing trade-offs and arguing that abandonment of joint filing entails unwanted consequences); Pamela B. Gann, *Abandoning Marital Status as a Factor in Allocating Income Tax Burdens*, 59 TEX. L. REV. 1, 67 (1980) (concluding that mandatory separate returns is the best reform followed by choice of filing status and earned-income deduction); S.L. Hurley, *The Unit of Taxation Under an*

can be used to illustrate two further aspects of the problem of household taxation: the “stacking effect” and the nontaxation of domestic labor.

The current tax system, like any joint-filing system, leads to a “stacking effect” that burdens the decision to work outside the home. Consider Case 3 again. The secondary earner—the lower-earning spouse whose decision to work outside the home is more tentative than that of the other (primary) earner—faces a large barrier to working outside the home.<sup>3</sup> Under progressive rates and joint filing, the secondary earner’s income is in effect “stacked” on top of the primary earner’s income because the secondary earner faces the couple’s marginal rate, which will be pushed up by the primary earner’s larger income. The more the primary earner makes, the higher the couple’s—and hence the secondary earner’s—marginal rate climbs. The secondary earner will face a much higher marginal rate—where behavior is influenced—than will an individual-filing single person. These considerations have led to a gradual shift among commentators toward favoring individual filing.<sup>4</sup>

Further, the nontaxation of domestic labor also affects secondary earners’ work decisions. Both individual and joint filing tax market labor

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*Ideal Progressive Income Tax*, OXFORD J. LEGAL STUD. 157, 157-60 (1984) (arguing that choice of progressive taxation and unit of taxation are not independent questions); Marjorie E. Kornhauser, *Love, Money, and the IRS: Family, Income-Sharing, and the Joint Income Tax Return*, 45 HASTINGS L.J. 63 (1993) [hereinafter Kornhauser, *Love, Money, and the IRS*] (arguing for individual filing because of nonpooling of income and burden on secondary earner); Edward J. McCaffery, *Slouching Towards Equality: Gender Discrimination, Market Efficiency, and Social Change*, 103 YALE L.J. 595 (1993) (discussing the appeal of the efficiency analysis); Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Gender Biases in the Code*, 40 UCLA L. REV. 983 (1993) [hereinafter McCaffery, *Fresh Look*] (arguing that tax laws contribute to the marginalization of women in the workplace); Michael J. McIntyre, *Individual Filing in the Personal Income Tax: Prolegomena to Future Discussion*, 58 N.C. L. REV. 469, 484, 488-89 (1980) (defending joint filing as reflecting pooling of married couples’ income); Michael J. McIntyre & Oliver Oldman, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 HARV. L. REV. 1573 (1977) (defending income-splitting under joint filing as reflecting joint benefit from marital income); Harvey S. Rosen, *Is It Time to Abandon Joint Filing?*, 30 NAT’L TAX J. 423 (1977) (arguing primarily on efficiency grounds for individual filing); Lawrence Zelenak, *Marriage and the Income Tax*, 67 S. CAL. L. REV. 339 (1994) [hereinafter Zelenak, *Marriage and the Income Tax*] (arguing for separate returns); Laura Ann Davis, Note, *A Feminist Justification for the Adoption of an Individual Filing System*, 62 S. CAL. L. REV. 197 (1988) (arguing from impact on women for individual over joint filing).

3. This Article uses masculine pronouns for the less elastic earner and feminine pronouns for the more elastic earner both to reflect a traditional pattern that persists to some degree and to highlight the resulting feminist issue. See *infra* notes 4-8 and accompanying text.

4. See, e.g., MCCAFFERY, *supra* note 2, at 164-68 (discussing optimal-taxation approach to the taxation of women in light of labor supply elasticities). See also, e.g., Martin Feldstein & Daniel R. Feenberg, *The Taxation of Two-Earner Families*, in EMPIRICAL FOUNDATIONS OF HOUSEHOLD TAXATION 39, 69-71 (Martin Feldstein & James M. Poterba eds., 1996) (estimating deadweight loss from taxation in light of women’s labor supply elasticities).

but do nothing to tax domestic labor that is compensated for by marital sharing of resources. Marital “sharing” of income is itself a concept that covers a spectrum of situations from exchange—for example, money income for domestic services—at one end to pure gift-giving at the other. Although there may be no clear-cut line dividing exchange-sharing and gift-sharing, we must worry about the close substitution relationship between market labor that is remunerated by wages and domestic labor that is compensated with marital “sharing.” In a no-tax world, *B* would make some trade-off between the two. But, under both individual and joint filing, *B* is taxed on the market-labor income, while *B* is *not* taxed on “shared” income from *A*. Even under individual filing, which is commonly believed to benefit secondary earners, net cash transfers to the secondary earner within the marriage do not raise the secondary earner’s marginal rate. Thus, the payment for domestic services is untaxed to the secondary earner, thereby increasing the attractiveness of domestic over market labor relative to the situation in a no-tax world.<sup>5</sup> As we will see, this situation is further complicated by home production: The differential tax rates under individual filing makes the relative attractiveness of using each spouse’s time in the home different from what it would be in a no-tax or joint-filing world.

The largest group of “secondary” earners are married women,<sup>6</sup> for whom the stacking effect and the nontaxation of imputed income (and of maritally-exchanged domestic labor) create incentives pushing them in the direction of labor in the home rather than in the marketplace.<sup>7</sup> The some-

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5. Taxpayers with and without imputed income can be put on a more even footing either by taxing imputed income, which is usually thought impractical, or by giving deductions (or credits) to those wage-earners who incur the corresponding expenses of hiring third parties to render the services in question. A child-care deduction, credit, or other subsidy can lessen the effects of the nontaxation of imputed income and of maritally exchanged domestic labor. See, e.g., MCCAFFERY, *supra* note 2, at 114-18; Daniel C. Schaffer & Donald H. Berman, *Dissents and Concurrences: Two Cheers for the Child Care Deduction*, 28 TAX L. REV. 535, 536-45 (1973). The Internal Revenue Code currently provides for a child-care tax credit, see I.R.C. § 21 (1994 & Supp. II 1996), and an exclusion for up to \$5,000 in dependent care assistance provided to the taxpayer, see *id.* § 129. Less targeted to child care are the child tax credit, see *id.* § 24 (West Supp. 1998) (principal element of Taxpayer Relief Act of 1997 providing credit against tax of \$500 (\$400 for 1998) for each child under the age of 17) and the dependent exemption, see *id.* § 152 (1994).

6. See, e.g., MCCAFFERY, *supra* note 2, at 19-23.

7. As explained in Part II.B.4 *infra*, the benefit of these services constitute (i) “imputed income” and (ii) one leg of a marital exchange of domestic work for shared income. Both of these are not taxed. Imputed income is the increase in economic well-being from self-performed services or from property. For example, consider two people with similar preferences and facing the same wage rate. Person *A* works 10 hours more than Person *B* and earns an extra \$200 but has to use that \$200 to hire a third party to provide child care or housecleaning services. Person *B* uses the 10 hours to perform the services herself. In that case, *A* and *B* are equally well-off, and the increase in economic

what unfortunate term “secondary” does *not* mean that women’s work in the marketplace is somehow normatively less important than men’s. It does mean that, because women face lower wages in the marketplace and continuing gender stereotypes about domestic labor, married women’s choice of whether to work outside the home is far more sensitive to incentives than that of their husbands.<sup>8</sup> In light of these realities, it is essential that the tax system be reformed in order that it not aggravate—as it now does—the disincentives for married women to work.

The present joint-filing system is clearly not an optimal approach to the trilemma. It combines a marriage penalty for many couples and a penalty on work for many secondary earners.<sup>9</sup> Changing patterns of family life toward more two-earner couples make the marriage penalty loom ever larger,<sup>10</sup> and calls for reform are becoming more insistent.<sup>11</sup> On the other hand, despite its popularity in the literature, individual filing takes no account of sharing within marriages, provides no incentive to share control over earned income, and taxes market but not domestic labor. Moreover, household taxation in the United States has veered from individual filing at the dawn of the income tax to various forms of joint filing, and this history strongly suggests that we will never achieve equilibrium at either pole, individual or joint filing.<sup>12</sup>

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well-being that *B* achieves through the self-rendered services is called imputed income. Because the concept of imputed income is an unintuitive one and because taxing it would be administratively difficult, imputed income escapes taxation. See, e.g., Thomas Chancellor, *Imputed Income and the Ideal Income Tax*, 67 OR. L. REV. 561, 605-09 (1988); McCaffery, *Fresh Look*, *supra* note 2, at 1055-58; McIntyre & Oldman, *supra* note 2, at 1617-20.

8. See, e.g., Feldstein & Feenberg, *supra* note 4, at 40, 69-71; Mark R. Killingsworth & James J. Heckman, *Female Labor Supply: A Survey*, in 1 HANDBOOK OF LABOR ECONOMICS 103 (Orley Ashenfelter & Richard Layard eds., 1986). See also *infra* Parts II.B.3 and III.D.1.

9. See I.R.C. § 1(a) (West Supp. 1998). Under the Code, couples do have the option to file separately, see *id.* § 1(d), but the rate schedule is designed to make the combined tax liabilities of the two spouses higher under the separate filing option than under joint filing. There can sometimes be an advantage in separate filing where a deductible expense is subject to a floor defined in terms of percentage of adjusted gross income: The lower adjusted gross incomes of the spouses under separate filing reduces such floors. See, e.g., *id.* § 67(a) (1994) (subjecting miscellaneous itemized deductions to a disallowance of 2% of adjusted gross income); *id.* § 165(h)(2) (West Supp. 1998) (allowing net casualty losses only to the extent they exceed 10% of adjusted gross income); *id.* § 213(a) (1994 & Supp. II 1996) (allowing deduction for uncompensated medical expenses only to extent that such expenses exceed 7.5% of adjusted gross income), but only in rare cases will such “floor-lowering” advantages outweigh the disadvantage built into the married-filing-separately rate schedule of § 1(d).

10. See CONGRESSIONAL BUDGET OFFICE, FOR BETTER OR FOR WORSE: MARRIAGE AND THE FEDERAL INCOME TAX (1997) (documenting lack of marriage and singles penalties in present income tax and surveying traditional solutions).

11. See, e.g., Marriage Tax Elimination Act, H.R. 2456, 105th Cong. (1997) (proposing legislation that would implement a traditional solution of allowing married couples a choice of filing jointly or separately). See also *infra* Part V.

12. On some lessons to be drawn from this tortuous history, see *infra* Part IV.

In this Article, I will explore a third alternative, which I call “intermediate filing.” Instead of allowing couples to “split” their income as joint filers or forcing them to file as individuals, intermediate filing presents couples with a choice of individual filing as a default or *fractional splitting*. The ratio of the split would govern both tax treatment and property division (broadly defined) on divorce. If the couple negotiated a 50/50 ratio, then the couple (and the primary earner in particular) could lower taxes by as much as they would under joint filing, but all property including human capital built up during the marriage would be divided equally on divorce. If the negotiated ratio were 60/40, the primary earner and the household overall would have to pay higher taxes in order to avoid the even split on divorce.

As elaborated below, intermediate filing carries with it a number of practical advantages. First, intermediate filing is designed to calibrate tax treatment to the amount of sharing in the marriage, but it does not face the need to measure sharing directly. Instead, the countervailing incentives facing the higher-income spouse (to wish for a relatively even ratio for taxes but a less even one for divorce) force him into receiving the tax advantage only to the extent that he is willing to share ownership. By tying the tax and family law treatments of marital property, the system to a large extent *defines* the ownership rights of the spouses.

This tie-in leads to an incentive structure beneficial from both efficiency and feminist standpoints. The ratio under intermediate filing has the effect of taxing household labor that is compensated for by sharing. As I will show, intermediate filing is likely to be a good compromise between eliminating distortions in labor supply and home production. Furthermore, the system gives primary earners an incentive to share: At the margin, further sharing under the system will lead to lower taxes.

The contractarian nature of the intermediate-filing system shows promise of improving the process of marriage formation. This system would serve as a particularly effective penalty default on the better-off spouse, forcing that spouse to reveal information about his intentions for the marriage whether or not he contracts around default individual filing. Also, by functioning as a system of liquidated damages, the use of the ratio as a division rule on divorce would both tend to benefit women and induce the efficient level of precaution in the first place.

That intermediate filing has never been proposed is not surprising, because the conventional wisdom rests on two unfounded assumptions, which, if true, would present great obstacles to such a system. These two assumptions have made the trilemma seem more dire than it is and have

led many to believe that progressive rates inevitably lead to unacceptable trade-offs.<sup>13</sup>

First, it is almost universally assumed that we must base our choice of taxpayer for any given income on existing categories of ownership of the income or of the underlying asset. However, the existing set of such concepts is not adequate for tax purposes. Any filing system requires some basis for deciding how much splitting to allow. The Internal Revenue Code fails to provide a comprehensive definition of ownership.<sup>14</sup> Therefore, it is natural, but far from necessary, to look to existing concepts of ownership to decide whom to tax on what income. It would appear that if we wish to allow some type of splitting other than pure joint filing, we would need to find some definition of spousal rights to supply the basis for the split. A definition might be expected from family or property law. For example, a splitting system might allow splitting to the extent of community property: Income that constitutes community property would be split, but separate income would not. As discussed below, no such existing categories, including even those of community property, furnish a remotely fair or efficient basis on which to allow splitting.<sup>15</sup> Thus, if inter-

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13. Before turning to questions of marriage neutrality and the taxation of couples, it is worth remarking that it is true that giving up on progressive rates—the remaining “horn” of the trilemma—would remove this trade-off between the penalties (for singles or married people) on the one hand and “equal” treatment of couples with equal total household income on the other. In the Article, however, I will assume progressive rates for several reasons. First, progressivity is an important issue in its own right. See, e.g., WALTER J. BLUM & HARRY KALVEN, JR., *THE UNEASY CASE FOR PROGRESSIVE TAXATION* 39-104 (1953) (challenging arguments for progressive taxation); CHARLES O. GALVIN & BORIS I. BITTKER, *THE INCOME TAX: HOW PROGRESSIVE SHOULD IT BE?* 25-52 (1969) (arguing uneasiness of the case for any tax base including proportional taxation); Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CAL. L. REV. 1905, 1966-67 (1987) (arguing from optimal tax theory for some version of progressive rates); Walter J. Blum, *Revisiting the Uneasy Case for Progressive Taxation*, 60 TAXES 16, 21 (1982) (arguing that progressive taxation is even more uneasy in the 1980s than in the 1950s); Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L.J. 259, 259-86 (1983) (arguing that an estate tax has important role in enhancing progressivity of the tax system). The endurance of progressive rates reflects a long-held commitment by Congress to effecting some redistribution through the Internal Revenue Code. See Michael L. Roberts & Peggy A. Hite, *Progressive Taxation, Fairness, and Compliance*, 16 L. & POL'Y 27, 44 (1994) (reporting results of a nationwide survey in which 60% to 66% of respondents supported a progressive tax system). But, as soon as we allow some degree of progressivity, we are presented with the unattractive choices outlined above. Indeed, the trilemma only arises on the assumption that progressive rates are a priority, and, therefore, the real challenge of the trilemma is to accommodate this basic assumption of progressive rates with the least objectionable of the remaining alternatives.

14. See Noël B. Cunningham & Deborah H. Schenk, *Taxation Without Realization: A “Revolutionary” Approach to Ownership*, 47 TAX L. REV. 725, 727 (1992) (arguing for extension of approach behind the rules of I.R.C. § 1286 (1994) for bonds with attached coupons to defining ownership under the Code generally).

15. See *infra* Part V.

mediate filing is desirable, it cannot rest on these established property- or family-law categories.

Second, it is believed that giving couples a choice of filing status inevitably leads to an overuse of joint filing. Given a choice, couples supposedly will opt for joint filing to lower their overall household taxes, even if they share income less than joint filing would suggest. The history of household taxation in the United States<sup>16</sup> is taken to suggest that allowing couples a choice of filing status—whether joint versus individual or somewhere in between—would present a clear-cut incentive to elect joint filing to minimize taxes, regardless of the fairness or efficiency. Given a choice between lower and higher taxes, couples would opt for the lower taxes under joint filing regardless of whether this reflects a sensible positive or normative description of marriage and regardless of the social consequences.<sup>17</sup> This historical experience has probably contributed to the focus on forcing all marriages into a model that justifies either individual or joint filing.

These first two assumptions—that the Code must rely on existing categories from property and family law and that any choice of filing status degenerates into joint filing—are erroneous and have prevented us from seeing the possibility of doing better than the traditional alternatives of individual and joint filing. These two mistaken assumptions have obscured the role in household taxation of a third assumption that is actually more of a value judgment: Sharing is an important determinant of how to tax married couples.

The nature of this relationship between marital sharing and household taxation, however, will become clearer when intermediate filing is considered. Indeed, as we will see, intermediate filing can be regarded as a thought experiment that lays bare the role that sharing plays in our attitudes toward the taxation of various groups of taxpayers, not just married couples. Examples of such groups include parents and their children, other relatives, cohabiting couples, religious orders, communes, and the vast array of other groups that social life gives rise to.

The next part of this Article will introduce the problem of marital taxation by examining various models of marriage and the conflicting lessons drawn from them for the long-standing individual-versus-joint-filing debate. In Part III, I will present the proposed system of intermediate fil-

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16. See *infra* Part IV.

17. This assumes similar rates for joint filers. On the present system of special rates for those who could file jointly, see *supra* note 9.

ing based on a self-assessed ratio for income-splitting. That section will demonstrate the wide range of equity and efficiency advantages of such a system over either of the two traditional alternatives. It will also consider issues of federalism, geographical disparity, and joint and several liability. Part IV will reexamine the history of household taxation with an eye to the possibility and historical absence of intermediate filing. In Part V, I will compare self-assessed intermediate filing to other "intermediate" approaches. Part VI will generalize the intermediate approach to marital taxation explored here to provide a new theory of the role in taxation of sharing by "conduit" taxpayers with other members of a given social group. Part VII concludes the Article by suggesting that intermediate filing merits consideration that will help enhance awareness of attitudes toward sharing in marriage.

## II. PARTIAL SHARING IN MARRIAGE

In this part, I will show that our attitude towards joint or separate filing should depend to a large extent on the degree of sharing that occurs within a given marriage. Individual filing reflects an understatement of sharing and joint filing overstates sharing in most marriages. Neither system is fine-grained enough to capture the wide range of sharing occurring in marriages, and the perverse equity and efficiency consequences of either joint- or individual-filing systems stem directly from the one-size-fits-all approach that each system takes.

### A. BENEFITS AND BURDENS OF MARRIAGE

Because intermediate filing will address the overstatement and understatement of certain benefits and burdens of marriage, this section will first survey those aspects of marriage that have been featured in the joint-versus-individual-filing debate. Afterwards, I will point out the role that the full range of sharing in marriages should play in our thinking about the questions of income-splitting and filing in the income tax.

#### 1. *Untaxed Benefits and Burdens of Marriage*

With marriage comes a variety of untaxed benefits and burdens. Although some of these benefits and burdens are not unique to marriage, the associated incentive effects do have special implications in the context of marriage.

The main benefits from marriage include what are often termed “economies of scale”—many of which are really public goods<sup>18</sup> within the marriage—and the sum of imputed income.<sup>19</sup> Neither of these types of marital benefits is taxed, but, although characteristic of marriages, neither is unique to them. Nontaxation of imputed income occurs widely outside of marriage as well.<sup>20</sup>

However, nontaxation of the imputed income from household labor, as well as the nontaxation of a marital exchange of such labor for shared income, increases the incentive for the secondary earner to work in the home rather than in the marketplace. That the income tax thus pushes women in particular toward traditional housework is a central problem of marital income taxation.<sup>21</sup> Moreover, even (as is customary) calling the domestic labor here “imputed income” reflects an implicit, but by no means obvious, choice of the family rather than the individual as the “economic unit” that makes decisions and experiences utility.<sup>22</sup> As we will see, if we focus on the individual members of the marriage, it may turn out that one spouse is trading domestic services in return for money income from the other spouse. If so, then the traded component of the domestic services are *not* imputed income because the services are traded rather than rendered simply for oneself (as is required for true imputed income). Although the benefits of housework are often imputed income, especially if done by a single person living alone, the common but erroneous assumption that the benefit of housework is always imputed income reflects an implicit acceptance of the “family-unity” model.<sup>23</sup> In such a view, domes-

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18. A public good is one whose consumption is nonexclusive and (usually) nonrival. In a classic example, national defense cannot be allocated only to those citizens who are willing to pay, and one citizen’s enjoyment of security from national defense does not diminish the benefit to other citizens or reduce consumption elsewhere. See, e.g., Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387, 387-89 (1954); Paul A. Samuelson, *Diagrammatic Exposition of a Theory of Public Expenditures*, 37 REV. ECON. & STAT. 350, 350 (1955).

19. On imputed income, see *supra* note 7 and accompanying text.

20. This is true most notably in the context of owner-occupied housing. Compare *A*, who invests \$100,000 and uses the return to pay rent, and *B*, who spends the \$100,000 on home ownership. *A* must pay tax on the return to her investment but *B*, although economically no better or worse off than *A*, does not pay tax on the benefit of living in the housing *B* owns—*B*’s imputed income from the asset. See, e.g., Richard Goode, *Imputed Rent of Owner-Occupied Dwellings Under the Income Tax*, 15 J. FIN. 504, 504-25 (1960) (discussing implications of excluding from income tax imputed income from owner-occupied housing and possible responses to discriminatory effects).

21. See, e.g., MCCAFFERY, *supra* note 2, at 20-26; Davis, *supra* note 2, at 210-14; Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 372-75.

22. See *infra* Part II.B.

23. See, e.g., MCCAFFERY, *supra* note 2, at 26, 120-26, 178-79. Edward McCaffery asserts that:

Virtually all of the services that the spouse who stays at home performs constitute untaxed imputed income, and it is clear that the need for such services increases, first with marriage,

tic services are performed by the marital unity for "itself." However, once we take into account the individuals within the marriage and the possibility of nonmarket exchange between them, there is little reason to regard the entire benefit of domestic services as just another instance of imputed income.

Recall that a secondary earner like *C'* in Case 3 of the trilemma (where *C* earns \$20,000 and *C'* earns \$0)<sup>24</sup> is often faced with a choice of working in the marketplace and using after-tax income to pay for services such as child care or staying at home and providing them herself. If child-care costs \$10,000 and *C'* faces a marginal rate of twenty percent, for instance, *C'* will have to earn \$12,500 just to have enough to pay for child care that she could have provided herself tax-free.<sup>25</sup> Thus, while it is true that marriage gives rise to benefits that are not taxed otherwise, in the case of imputed income the incentive effect within the marriage is of great concern.<sup>26</sup> Further, strong empirical studies show that two-earner families incur substantial additional expenditures that correspond to items of "imputed income" in a one-earner family; these include child care, cleaning, and convenience food expenditures.<sup>27</sup> Furthermore, employed married women spend significantly less time on housework than wives who do not work outside the home, but husbands whose wives work in the marketplace generally do not perform significantly more housework than husbands whose wives are not employed outside the home.<sup>28</sup> Thus, the trade-

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and later, dramatically, with children . . . . The family would [if the secondary earner works outside the home] have to pay for a variety of services—child care and housekeeping primarily among them—with after-tax dollars.

*Id.* at 121. See also Note, *The Case for Mandatory Separate Filing by Married Persons*, 91 YALE L.J. 363, 377 & n.57 (1981) (arguing against joint filing because housework done by the secondary earner is imputed income exchanged for resources from the primary earner). *But cf.* Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 356 n.85 (criticizing justification of nontaxation of wife in exchange relationship based on nontaxation of imputed income and noting that exchange element is inconsistent with imputed income).

24. See *supra* note 1 and accompanying text.

25. That is,  $\$12,500 - (.2) \times \$12,500 = \$10,000$ . More generally, the amount  $x$  that the secondary earner will have to earn in the marketplace to pay for the child care can be given by  $x = S / (1 - r)$ , where  $S$  is the amount that child care (or other relevant services) costs and  $r$  is the earner's marginal rate. Of course, as  $r$  increases—say because of large earnings of the primary earner under a system of joint filing—so does  $x$ , the amount the secondary earner has to make just to break even with the imputed income situation.

26. It is a concern for both feminist and efficiency reasons. See *infra* Parts III.D and III.E.

27. See Sandra L. Hanson & Theodora Ooms, *The Economic Costs and Rewards of Two-Earner, Two-Parent Families*, 53 J. MARRIAGE & FAM. 622 (1991).

28. See, e.g., BARBARA R. BERGMANN, *THE ECONOMIC EMERGENCE OF WOMEN* 261-66 (1986); PHILIP BLUMSTEIN & PEPPER SCHWARTZ, *AMERICAN COUPLES: MONEY, WORK, SEX* 144-46 (1983). See also, e.g., Anne L. Alstott, *Tax Policy and Feminism: Competing Goals and Institutional Choices*,

off between market earnings and imputed income falls heavily on the wife, who is typically the secondary (more elastic) earner.

As for public goods within the marriage, the consumption benefit from heating and lighting or even one kitchen, for example, may not decrease with the use of the other spouse, making such goods truly public. Under the heading of “scale economies” in home consumption, studies going back to Ernst Engel’s landmark study<sup>29</sup> a century ago have found that there are significant public goods or scale economies in household consumption.<sup>30</sup> The same aspect of nonexclusive enjoyment can be found in a common driveway, for instance, but we do not tax each neighbor on the full consumption benefit as long as we use income as an index to taxable well-being.<sup>31</sup> Furthermore, the nontaxation of the benefit of the common driveway can be seen as an instance of the general point that, in using income as a rough index to well-being, we do not tax consumer surplus.<sup>32</sup> That is, instead of trying to tax utilities, the Code taxes on the basis of market price, which reflects utility to the marginal consumer.

But the nontaxation of consumer surplus and domestic labor within the marriage more generally may well have incentive effects that are disturbing from a feminist point of view. If the primary earner—more often the husband than the wife—is the one whose earned income is supplying the public good within the marriage, the husband—especially if he controls the expenditure and is therefore more secure in the benefit—may well drive more utility from it. In that case, the utility is not evenly distributed (as it more likely would be between the neighbors with the common driveway). Instead, the husband may derive more utility for which he receives more of a tax advantage than does the wife. That is, if utility were taxed directly, the husband would have more incentive to share the re-

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96 COLUM. L. REV. 2001, 2023 & n.89 (1996) (noting that men’s domestic labor still “lag[s] far behind the increase in women’s market work” and citing studies with data on labor-force participation).

29. See Ernst Engel, *Die Lebenskosten Belgischer Arbeiter-Familien Früher und Jetzt*, 9 INT. STAT. INST. BULL. 1 (1895).

30. See, e.g., ANGUS DEATON & JOHN MUELLBAUER, *ECONOMICS AND CONSUMER BEHAVIOR* 192 (1980) (noting economies in home consumption and surveying literature); Reuben Gronau, *Home Production—A Survey*, in 1 HANDBOOK OF LABOR ECONOMICS, *supra* note 8, at 273, 289.

31. On approaches to the question of taxable well-being, especially in the marital context, see *infra* Part II.B.4.

32. Consumer surplus is the excess of a person’s willingness to pay (her reservation price) over the market price. By using market prices as measures of valuation, the Code does not tax consumer surplus. See, e.g., Treas. Reg. § 1.61-2(d) (as amended in 1995) (setting forth the basic rule that where services are paid for with property, the amount includable in an employee’s income as compensation is the fair market value of property). See generally MICHAEL J. GRAETZ & DEBORAH H. SCHENK, *FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES* 120 (3d ed. 1997) (discussing nontaxation of consumer surplus under Code and regulations).

sources with the wife (assuming he gets a nonzero utility from sharing) by relinquishing some of his financial control.

Other factors in marital well-being that come under the misleading rubric of “economies of scale” include the gains from specialization within the marriage. *True* scale economies in home production have not been addressed much in the literature,<sup>33</sup> and for good reason: Home-production output cannot be directly measured, and even information on the allocation of time in household production is very minimal.<sup>34</sup> More attention has been paid to the closely related question of “economies in home consumption” discussed earlier.

Instead of focusing on true economies of scale in home production, economists have studied in more detail the gains to a married couple from the division of labor within households. For example, if one spouse concentrates on home production and the other on market labor, each spouse can build up human capital specific to their tasks that two single people would be unable to do.<sup>35</sup> Of course, as a matter of basic values, we can certainly question whether the efficiency gain here is important enough to outweigh concerns among some feminists about traditional gender roles within the family.<sup>36</sup> Even from a purely efficiency-based point of view, we must be careful not to allow the legal framework to exaggerate the incentive for secondary earners to work within the home *beyond* the point that would exist in a no-tax world.

On the burden side, the primary earner may (or may not) be paying for support of the other spouse, depending on what the other spouse is contributing to the marriage, including “imputed income” from personally performed services. More generally, the primary earner may be sharing some cash income with the other spouse partially in return for the other spouse’s domestic labor. The extent to which this support or sharing is a burden remains very difficult to measure. As we will see, most economic analyses fail to distinguish sharing as gift-giving and sharing as part of marital exchange. There is little reason, however, to suppose that this bur-

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33. For there to be true economies of scale in household production, output must expand proportionately more quickly than amount of inputs.

34. See, e.g., Gronau, *supra* note 30, at 288-89.

35. See generally GARY S. BECKER, A TREATISE ON THE FAMILY 30-53 (enlarged ed. 1991) (discussing the household division of labor between men and women).

36. See MCCAFFERY, *supra* note 2, at 183-84, 287 n.183 (arguing that, even if joint or household filing were more efficient because of efficiency gains from specialized division of labor within the family, feminist arguments for individual filing should be maintained on justice grounds).

den or obligation corresponds to the amount of support a court would require on divorce.<sup>37</sup>

Moreover, the secondary earner often faces the choice of whether to specialize in market or domestic labor. Particularly in the case of secondary earners who specialize in work within the home, the secondary earner has foregone the development of job skills relevant for the marketplace. Again, there seems to be an inadequate relation of traditional support obligations to the burdens assumed by such a secondary earner, and the lack of compensation for the specialization of the wife has been a recurring complaint against traditional divorce law.<sup>38</sup> At the most general level, the issue is how the gains from marriage and the costs in achieving them are distributed among the marriage partners both during the marriage and on divorce.

## 2. *Control and Consumption of the Benefits of Marriage*

These special benefits and burdens of marriage are often not evenly distributed within the marriage. Very recent economic studies point to less than complete sharing in marriages. While married couples generally seem to pool consumption to a great extent, men seem typically to enjoy a greater degree of control over the economic benefits of marriage than do women.

There has been some doubt and much discussion about the extent to which joint consumption occurs in marriages and about the division of power and benefits between spouses. There remains, however, little hard evidence as to how much sharing actually goes on in marriages, or how “sharing” should be defined in the tax context. It is important to distinguish consumption and control: A primary earner might share consumption with a secondary earner (such as shared heating, lighting, housing, and vacations)<sup>39</sup> but not share control (decisionmaking over the consumption). Thus, the spouses might vacation together (shared consumption) but if the primary earner makes the decision of where to vacation, he has retained a degree of control greater than if he handed half of his extra cash earnings to his wife and they bargained over where to vacation. Further, the wife’s

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37. See *infra* Part V.

38. See, e.g., Katherine K. Baker, Comment, *Contracting for Security: Paying Married Women What They’ve Earned*, 55 U. CHI. L. REV. 1193, 1206-13, 1220-27 (1988) (documenting inadequacies in current law).

39. Shared consumption need not involve public goods. The primary earner might share income to fund consumption by the secondary earner, as in the case of vacations. The likelihood of shared consumption increases the more the primary earner’s utility function is dependent on that of the other spouse. See *infra* Parts II.B.3 and III.D.1.

increase in utility from consuming the vacation purchased with the extra income is less than it would be if she had chosen the vacation spot. There are two reasons for this conclusion. First, if each spouse has distinct utility functions and equal control, the wife's preferences would be given more weight and she would gain greater utility from the final choice.<sup>40</sup> Second, having control as opposed to mere ministerial management<sup>41</sup> may yield utility, in which case the husband has greater utility and the wife less utility than if control as well as consumption were shared.

Many previous studies of "sharing" within marriages make consumption the object of sharing. In attacking the old consensus among joint-filing proponents that spouses do pool income, Marjorie Kornhauser has reviewed the large literature on this topic and notes only one empirical study other than her own on the sharing of income among married couples.<sup>42</sup> A study by Philip Blumstein and Pepper Schwartz focused on attitudes toward pooling, where pooling seems to have meant at least pooled consumption (if not control).<sup>43</sup> They found that a substantial number of both men and women favored pooling and that a positive correlation existed between the amount to which they favored pooling and the length of their present relationship.<sup>44</sup>

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40. The resulting extra weighting of the husband's utility in the household's decisionmaking has efficiency implications. Under reasonable assumptions, there is a welfare loss that will positively correlate with greater divergence of the relative weighting from equality. See Patricia Apps & Ray Rees, *Taxation and the Household*, 35 J. PUB. ECON. 355, 362 (1988).

41. Jan Pahl makes the distinction between control that is "concerned with decisions such as which allocative system should be adopted within the household, which spouse should have the final say on major financial decisions," and the extent to which spouses have discretion over personal spending money and access to joint money. JAN PAHL, *MONEY AND MARRIAGE* 57 (1989). Management, on the other hand, "is concerned with putting into operation the particular allocation system which the couple has adopted." *Id.* For our purposes, control means decisionmaking authority whether exercised or not, as opposed to management, which is the handling of money in order to carry out those decisions (such as writing the checks for bills and balancing the checkbook).

42. See Kornhauser, *Love, Money, and the IRS*, *supra* note 2, at 84-85.

43. See BLUMSTEIN & SCHWARTZ, *supra* note 28, at 94-111.

44. See *id.* at 95. Among over 3,600 married couples, 69% of married women favored pooling, 19% were neutral, and 12% were against pooling. See *id.* at 101. Among husbands the corresponding numbers were 75%, 17%, and 8%. See *id.* Among unmarried cohabiting heterosexual couples, there was considerably less support for pooling, with only 27% of women and 32% of men for pooling, 29% of women and 31% of men neutral on pooling, and 44% of women and 37% of men opposed to pooling. See *id.* Among gay and lesbian couples, there was a strong positive correlation of positive attitudes toward pooling and the length of the relationship: For lesbians together for less than two years, 31% favored pooling; for those together for 2 to 10 years, 40% favored pooling; and for those in relationships more than 10 years, 59% favored pooling. See *id.* at 95. Among gay men, the corresponding numbers were 35%, 44%, and 68%. See *id.* The same positive correlation held among the married couples as well but starting from a higher base, with 63% of wives married less than two years favoring pooling and 67% of the husbands. See *id.*

There is also evidence that people typically overstate the amount of sharing that goes on in their own marriages. As noted earlier, if we allowed income-splitting to the extent of sharing, people would have an incentive to “overreport” the degree of sharing in their marriages. However, Kornhauser argues that even when people are asked about sharing and where (in our terms) there are no consequences to the answer, people do typically exaggerate the amount of sharing occurring in their marriages.<sup>45</sup> Jan Pahl conducted a study in which she interviewed couples jointly and then separately.<sup>46</sup> Pahl found wide discrepancies between the amount of pooling described by the couples in joint interviews and in separate interviews.<sup>47</sup>

The data show widespread support for the idea of pooling, but there has been some controversy over what the significance for tax policy of Blumstein and Schwartz’s results should be. Kornhauser considers the focus on attitudes to be beside the point: If married couples do not share as much as they say they report, then they should not receive the tax advantage of income-splitting.<sup>48</sup> Lawrence Zelenak disagrees on the grounds that the tax system should reflect people’s widely shared attitudes toward aspects of marriage such as the degree of sharing.<sup>49</sup> Quite possibly he adopts this view, because under current law there is no way to test couples’ degree of commitment to these positive attitudes toward sharing. As we will see, intermediate filing solves this dilemma: Under intermediate filing, people are allowed a degree of income-splitting that corresponds to the sharing of control, thus satisfying Kornhauser’s objections.<sup>50</sup> Once people have the opportunity to back up their professions of sharing with actions, Zelenak’s reliance on general attitudes is no longer necessary.

Measuring sharing is very difficult indeed. As is widely recognized, difficulties in measuring actual pooling include privacy concerns, the complexity of the phenomenon, and the multiplicity of interpretations with which the little data available are consistent.<sup>51</sup> Pahl found that women married to high-income men are less likely to have control over money

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45. See Kornhauser, *Love, Money, and the IRS*, *supra* note 2, at 86-87.

46. See PAHL, *supra* note 41, at 83-84.

47. See *id.*

48. See Kornhauser, *Love, Money, and the IRS*, *supra* note 2, at 86 n.64.

49. See Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 349-50.

50. See *infra* Part III.

51. See, e.g., Kornhauser, *Love, Money, and the IRS*, *supra* note 2, at 80-84. See also Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 350.

than are women married to lower-income men,<sup>52</sup> and many nonstatistical studies conclude that the husband often enjoys greater consumption within the marriage than does the wife.<sup>53</sup>

For consumption at least, census data can provide partial answers as to the degree of sharing. Zelenak notes that the high percentage of income spent on consumption in basic areas like food and shelter indicates a high degree of shared consumption.<sup>54</sup> However, these data are of limited use. First, while acknowledging the possibility that a high-income husband may spend far more on himself, Zelenak claims (without empirical support) that this is "hardly the norm."<sup>55</sup> Further, although it is true that the data indicate that opportunities for saving (which could more easily be separate) are limited,<sup>56</sup> savings should also include human capital. If one spouse is building up human capital and the other is not, pure joint consumption during the marriage is a far cry from an assurance of long-term sharing.<sup>57</sup> Finally, since control is not unrelated to rights on dissolution, imbalances in human capital may correlate with quite different degrees of control in the spouses even where they jointly consume during the marriage. *Control* over joint consumption is crucial.

Measuring control is at least as difficult as measuring joint consumption. But very recent economic work points to less than complete sharing of both control and consumption in a variety of societies. If couples pooled their income and control, increases in the wife's income relative to that of the husband should not alter the family's consumption pattern, assuming family income remains constant. There should be only an income effect for the family, but no substitution effect based on whose income supplies the family. But increases in the wife's income relative to that of the husband are associated with an increase in expenditures on restaurant meals, child care, and women's clothing,<sup>58</sup> and with decreases in expendi-

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52. See, e.g., Jan Pahl, *The Allocation of Money Within the Household*, in *THE STATE, THE LAW, AND THE FAMILY: CRITICAL PERSPECTIVES* 36, 43 (Michael D.A. Freeman ed., 1984).

53. See, e.g., BERGMANN, *supra* note 28, at 213-14; Christine Delphy & Diana Leonard, *Class Analysis, Gender Analysis and the Family*, in *GENDER AND STRATIFICATION* 57-73 (Rosemary Crompton & Michael Mann eds., 1986); Nancy C. Staudt, *Taxing Housework*, 84 *Geo. L.J.* 1571, 1594-96 (1996). For a much older study, see Michael Young, *Distribution of Income Within the Family*, 3 *BRIT. J. SOC.* 305 (1952).

54. See Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 351-52.

55. *Id.* at 352.

56. See *id.*

57. See *infra* Part III.E.

58. See, e.g., Martin Browning, François Bourguignon, Pierre-André Chiappori & Valérie Lechene, *Incomes and Outcomes: A Structural Model of Intrahousehold Allocation*, 102 *J. POL. ECON.* 1067 (1994) (women's clothing). See also Shelly Lundberg & Robert Pollak, *Bargaining and Distri-*

tures on alcohol and tobacco.<sup>59</sup> Nor can all of these patterns be explained as increased work-related expenses of the wife. Strikingly, these effects extend to children: Increases in a mother's control over family resources are associated in some societies with increases in the health, nutrition, and survival chances of the children.<sup>60</sup> The most dramatic of these recent studies is based on a "natural experiment." After the policy change in the United Kingdom in the late 1970s that moved a substantial child subsidy from the family to the wife, there was strong evidence of a shift towards women's and children's clothing and away from men's clothing.<sup>61</sup> The increased income was in the form of the subsidy, meaning that the shifts toward women's clothing cannot be explained by requirements of work. This provides evidence that, despite everyday professions in favor of sharing and despite the assumption of family unity in traditional economic models,<sup>62</sup> pooling is far from complete, and, very importantly for intermediate filing, the legal right to income *does* indeed increase control.

These results should strengthen the increasing skepticism about pooling and marital sharing of control among tax commentators. Kornhauser bases her doubts about sharing on a study that focuses on whether couples deposit earned income into joint or separate bank accounts.<sup>63</sup> Kornhauser takes the depositing of earned income into separate bank accounts as a proxy for nonpooling and in particular nonpooling for purposes of control, but concedes that separate bank accounts could in some cases be mere bookkeeping devices.<sup>64</sup> In a random survey of married people, Kornhauser found that 70% of respondents deposited earned income in separate accounts; in a survey of law students at one law school, 55.6% of married and cohabiting respondents answered that they use separate accounts for depositing earned income.<sup>65</sup> Kornhauser herself takes these as

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*bution in Marriage*, J. ECON. PERSP., Fall 1996, at 144 (collecting studies on restaurant meals, child care, and women's clothing).

59. See John Hoddinott & Lawrence Haddad, *Does Female Income Share Influence Household Expenditures?: Evidence from the Côte d'Ivoire*, 57 OXFORD BULL. ECON. & STAT. 77 (1995). See also Lundberg & Pollak, *supra* note 58, at 144.

60. See Lawrence Haddad & John Hoddinott, *Women's Income and Boy-Girl Anthropometric Status in the Côte d'Ivoire*, 22 WORLD DEV. 543 (1994); Duncan Thomas, *Intra-Household Resource Allocation: An Inferential Approach*, 25 J. HUM. RES. 635 (1990); Duncan Thomas, *Like Father, Like Son; Like Mother, Like Daughter: Parental Resources and Child Height*, 29 J. HUM. RES. 950 (1994).

61. See Shelly J. Lundberg, Robert A. Pollak & Terence J. Wales, *Do Husbands and Wives Pool Their Resources? Evidence from U.K. Child Benefit*, 32 J. HUM. RES. 463, 472-79 (1997).

62. See *infra* Part II.B.3.

63. See Kornhauser, *Love, Money, and the IRS*, *supra* note 2, at 86.

64. See *id.* at 82-84; Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 350.

65. See Kornhauser, *Love, Money, and the IRS*, *supra* note 2, at 86.

low numbers indicating widespread nonpooling.<sup>66</sup> Zelenak finds the numbers to indicate a fairly high degree of pooling: Because a separate account could more easily be considered de facto a joint asset by couples than could a joint account be considered de facto separate, the numbers represent a minimum.<sup>67</sup>

Also, some couples use a combination of joint and separate accounts. This could indicate more pooling, as Zelenak believes,<sup>68</sup> or this could reflect *partial* pooling. Indeed, in Kornhauser's random survey, fully 21% of the respondents did use a combination of joint and separate accounts, with only 9% using only separate accounts.<sup>69</sup> Again, it is worth emphasizing that pooling may fall anywhere on the spectrum from none to full, and neither pure joint filing nor pure individual filing captures the reality of the intermediate cases.

There is yet another reason to pay more attention to control than to consumption. Utility for the individuals in the marriage is probably a function not just of amounts consumed but also of control. Indeed, this is why notions of taxable well-being, upon which the income tax itself is based, tend to look more toward control rather than consumption. For our purposes, it is particularly interesting that this uneven distribution of benefits within many marriages means that the assumption of equal consumption implied by income-splitting (and joint filing) is off the mark.

If the couple were the only relevant unit for measuring utility (as is often assumed for a variety of reasons),<sup>70</sup> this might not matter. But compare couples *A-A'* and *B-B'*, in which *A* shares equally with *A'*, but *B* and *B'* consume or control resources very unequally. First of all, these couples are *not* similarly situated in a manner that will be relevant to the splitting question. The first couple approximates more closely the ideal of a sharing couple that seems to be implied by using married couples as the unit for measuring utility. We can even ask in what relevant sense the *non-sharing* couple is a married couple. At least, sharing is a defining feature in the model of companionate or equal-partners marriage<sup>71</sup> that underlies the use of the household as the unit of taxation. Second, who actually con-

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66. *See id.*

67. *See Zelenak, Marriage and the Income Tax, supra note 2, at 351.* Lawrence Zelenak also notes his disagreement with McCaffery's endorsement of Kornhauser's low-pooling interpretation of these data. *See Lawrence Zelenak, Tax and the Married Woman, 70 S. CAL. L. REV. 1021, 1029 n.42. (1997) [hereinafter Zelenak, Tax and the Married Woman] (reviewing MCCAFFERY, supra note 2).*

68. *See Zelenak, Marriage and the Income Tax, supra note 2, at 350.*

69. *See Kornhauser, Love, Money, and the IRS, supra note 2, at 86-87 nn.65-66.*

70. *See infra* Part II.B.3.

71. *See infra* Part II.B.1.

sumes or controls the benefits of marriage *does* matter unless we believe that individual utility within a couple did not matter, which would be reminiscent of the common-law theory of coverture under which women's legal identities merged completely into that of their husbands.<sup>72</sup> This is neither ethically nor economically sensible. Further, if we wish to promote closely integrated, sharing marriages, it is quite appropriate that the tax burden on relatively nonsharing *B-B'* will be higher than on relatively sharing couple *A-A'*. Finally, the degree of sharing that occurs may fall somewhere between the poles of full pooling and nonpooling of income and assets. As we will see, the key is to make sure that couples such as *B-B'* can lower their tax burden *only to the extent that* more sharing actually occurs.

### B. MODELS OF MARRIAGE

Models of marriage tend to stress those aspects of marriage characterized by sharing or they emphasize how far actual sharing falls from this ideal. In this section, I will examine various normative and descriptive models of marriage with an eye to how they justify either joint or individual filing. Because the literature on this topic is extensive, I will focus on those aspects of the debate that have led to an acceptance of individual filing, particularly in the feminist tax literature.

As I will argue, the increasing acceptance of individual filing correctly reflects a perceived mismatch between the rhetoric surrounding marriage and the reality of marriage. As noted in the previous section, people generally profess support for more sharing in marriages than actually occurs. This mismatch is then coupled with a belief that, although tax laws can do little to promote equality, we must ensure that they present as few obstacles to married women's economic advancement as possible. Thus, the reality of unequal sharing in marriages justifies individual filing as a least bad alternative, despite its own inaccuracies.

By contrast, in an earlier day, an unquestioned belief that full sharing occurs in marriages similarly led to an acceptance of joint filing.<sup>73</sup> Ulti-

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72. Under the common-law doctrine of coverture, a wife's legal identity merged on marriage with that of her husband, placing her "in the same legal category as wards, lunatics, idiots, and outlaws." Janelle Greenberg, *The Legal Status of the English Woman in Early Eighteenth-Century Common Law and Equity*, in 4 *STUDIES IN EIGHTEENTH-CENTURY CULTURE* 171-72 (Harold E. Pagliaro ed., 1975). In equity, married women enjoyed somewhat greater legal rights. *See id.* at 176.

73. *See, e.g.,* McIntyre, *supra* note 2, at 469-71; McIntyre & Oldman, *supra* note 2, at 1578 ("we believe that married couples should be assumed to share their income equally"); *id.* at 1590 ("[E]qual-income couples should pay equal taxes, since each member of the couple will benefit more or less equally from the total available income without regard to the source distribution."). *But see,*

mately, however, this persistent but false assumption that we face a simple choice of joint or individual filing has led to an exaggeration of the abundance or lack of sharing in marriage. Because tax policy commentators generally seek to justify joint or individual filing, the models of marriage chosen have tended to emphasize the extremes of sharing or the lack of it in marriage. However, many marriages exhibit *some* degree of less-than-complete sharing. Because not all marriages exhibit the extremes of sharing—no sharing or total sharing—the models used to justify individual or joint filing do violence to the diverse reality of marriages. In later sections, I will show that if tax and family law are treated as an integrated whole, we can begin to solve the problems of the mismatch between normative and positive models of marriage.

### 1. *Companionate Marriage and the Partnership Model*

The notion of equal sharing in marriage falls under a variety of labels and has led to a surprisingly wide variety of normative prescriptions for family law. First, the idea of the equal-sharing model has a long pedigree, despite the fact it has never been close to being fully practiced during most of its history. Michel Foucault has documented the rise in Western societies of the ideal marriage of equals based on mutual respect, affection, and support—what Richard Posner terms “companionate marriage.”<sup>74</sup> More recently, feminists have explored what that theory calls for and how practice falls short of the ideal.<sup>75</sup> Borrowing legal terminology, some have advocated a “partnership” model of marriage.<sup>76</sup> However, this metaphor is sometimes taken as implying a unity of interests in marriage that does not exist, especially in light of less than full sharing in marriages.<sup>77</sup> Interest-

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*e.g.*, Louise Dulude, *Taxation of the Spouses: A Comparison of Canadian, American, British, French and Swedish Law*, 23 OSGOODE HALL L.J. 67, 88 (1985) (disagreeing with this assumption); Kornhauser, *Love, Money, and the IRS*, *supra* note 2, at 80-91 (disputing assumption of marital pooling of income). Zelenak believes that couples pool consumption but that income should be taxed to the earner. See Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 348-63. For further discussion, see *supra* Part II.A.2.

74. See MICHEL FOUCAULT, *THE CARE OF THE SELF* 72-80, 228-32 (Robert Hurley trans., 1986). See also RICHARD A. POSNER, *SEX AND REASON* 45 (1992) (discussing Foucault on the rise of what Posner terms “companionate marriage” and defining this term as “marriage between at least approximate equals, based on mutual respect and affection, and involving close and continuous association in child rearing, household management, and other activities”).

75. See PEPPER SCHWARTZ, *PEER MARRIAGES* (1994) (documenting the ideal of a “peer marriage” in which resources and responsibilities are shared and deviation of practice from such an ideal); Marjorie E. Kornhauser, *Theory Versus Reality: The Partnership Model of Marriage in Family and Income Tax Law*, 69 TEMP. L. REV. 1413, 1425 (1996) [hereinafter Kornhauser, *Partnership Model*].

76. See Kornhauser, *Partnership Model*, *supra* note 75, at 1414-24.

77. See *supra* Part II.A.2.

ingly, more recent partnership law does *not* require a complete unity of interests among partners.<sup>78</sup> In general, as noted above, we can say that in marriage, as in partnerships, the extent to which the marital partners' interests converge or diverge will differ widely in individual cases. As I will argue, a system tailored to this full diversity and designed to force information disclosure will not lead to the mismatches between rhetoric and reality about which feminists rightly complain.

Many feminists have objected to the partnership model because it does not reflect reality. Criticisms can be divided into two groups. Some accept that the partnership ideal has some merit but that the empty rhetoric of equality winds up providing women and children too little protection and well-being when marriages end.<sup>79</sup> Others find that the partnership model inappropriately "commoditizes" the community of the family.<sup>80</sup> Broadly speaking, two approaches have been taken to remedy the defects in the partnership model: Put teeth into it or discard it. As we will see, the intermediate-filing approach dovetails well with an approach to property division that meets many of these criticisms.

Many feminists seek a reform of marital property and divorce law that would bring legal reality more in line with the rhetoric of the partnership model. Thus, many divorce-reform proposals focus on a more equal division of assets on divorce. Under a more nuanced analogy of divorce law to partnership law, human capital in the spouses, for instance, would be part of the calculation of division on dissolution.<sup>81</sup> Because equal sharing in marriages is not the universal rule,<sup>82</sup> the partnership model as reflected in

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78. See Kornhauser, *Partnership Model*, *supra* note 75, at 1425 & n.28 (noting that under the 1914 Uniform Partnership Act, partners are prohibited by strict fiduciary duties from "acting in their own self-interest in contrast to the partnership's interest," but that section 404(e) of the Revised Uniform Partnership Act recognizes that the partners' unity of interests is not complete when it provides that a "partner's action in his own self-interest is not a violation of his fiduciary duty per se").

79. See generally Symposium, *Divorce and Feminist Legal Theory*, 82 GEO. L.J. 2119 (1994). See, e.g., Bea A. Smith, *The Partnership Theory of Marriage: A Borrowed Solution Fails*, 68 TEX. L. REV. 689 (1990); Cynthia Starnes, *Divorce and the Displaced Homemaker: A Discourse on Playing with Dolls, Partnership Buyouts and Dissociation Under No-Fault*, 60 U. CHI. L. REV. 67 (1993). On post-divorce poverty among women and children, see LENORE J. WEITZMAN, *THE DIVORCE REVOLUTION* 337-56 (1985).

80. See, e.g., Milton C. Regan, Jr., *Spouses and Strangers: Divorce Obligations and Property Rhetoric*, 82 GEO. L.J. 2303 (1994).

81. See, e.g., Smith, *supra* note 79; Starnes, *supra* note 79. See also Kornhauser, *Partnership Model*, *supra* note 75, at 1419-23. For the author's discussion on this subject, see *infra* Part III.E.

82. See *supra* Part II.A.2.

current law overstates sharing and does nothing to enforce sharing or equality.<sup>83</sup>

Such proposals for reforming the partnership analogy in divorce law are often justified on the basis that default rules should reflect what a majority of contracting parties would have bargained for. Although this may well describe a great number of contractual defaults, particularly in off-the-rack legal forms like partnerships, this is certainly not the only approach to defaults. Later, I will describe how the penalty defaults built into intermediate filing can be used to improve the marital contracting process.<sup>84</sup>

## 2. *The Contractarian Approach to Family Law*

The other major group of feminist commentators would abandon the partnership model. The major competitor of the companionate or partnership model is the contractarian model. The contractarian approach differs from the partnership model by seeking an implicit contract in the marriage rather than looking to off-the-rack rules already set up by the law. In other words, the contractarian approach, rather than looking mechanically to rules about dissolution, asks instead what the parties intended to contract for in the first place. In particular, a partnership model typically seeks to divide up conventional forms of property, which do not include human capital. The contractarian approach, however, might ask what a wife who stays at home or puts a husband through professional school was contracting for.<sup>85</sup> Such approaches lead very naturally to a broadening of property division on divorce to include human capital built up during the marriage. If we find that the wife was contracting for a degree of security beyond that implied by equitable distribution of conventional property on divorce, we have some reason to look to human capital to supply the stream of income after divorce that she implicitly contracted for all along.

Some feminists' critiques can be called "contractarian" in only the loosest sense. Some find that family patterns are so unequal to begin with that women are entitled to more than an equal share.<sup>86</sup> Most importantly for our purposes, such commentators share with the contractarians a rejection of the unity of interest implied by the partnership model, although

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83. I will show this overstatement and lack of sharing or equality enforcement in detail below with community property. *See infra* Part V.A.

84. *See infra* Parts III.D.2 and III.E.

85. *See, e.g.*, Baker, *supra* note 38, at 1213-25.

86. *See, e.g.*, MARTHA ALBERTSON FINEMAN, *THE ILLUSION OF EQUALITY: THE RHETORIC AND REALITY OF DIVORCE REFORM 2-6*, 29 (1991).

they would rest their conclusions less on an implicit bargain than on more general notions of entitlement.<sup>87</sup>

As we will see, intermediate filing has implications for family law. By providing for “penalty defaults” that the primary earner will have an incentive to contract around, we can improve the bargaining position of women.<sup>88</sup> That is, the inequality that this last-mentioned group of theorists base their entitlements on can be at least partially remedied by changing the rules under which bargaining takes place.

### 3. *Economic Models of Marriage*

In a manner roughly like the partnership and contractarian models of marriage, economic models can be divided into those that take the couple as a unity for purposes of utility and welfare analysis, and those models that are based on individual spouses as the locus of utility. Two further distinctions important for us but not consistently made by economic models include: labor in the home versus leisure, and domestic exchange versus altruistic sharing.

One threshold problem with many economic models is that, in seeking a simple take on the question of how households will behave as a whole, they assume away the question of the proper unit for measuring utility and for analyzing decisionmaking. In traditional analysis, families are treated as firms or production functions for purposes of production, and as individuals or utility functions on the consumption side. Theories about individual-choice behavior are then based on a single household utility function.<sup>89</sup> Under the family-unity approach, the family is then often treated as an extension of its head, with the head making the decisions and every one equally well off.<sup>90</sup>

However, when we are concerned with the distribution of goods and utilities *within* the marriage, we must push the analysis below the family level. Economists who challenge the unitary model theorize the intrafamily decision process in several different ways,<sup>91</sup> but these “non-unitary”

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87. See Kornhauser, *Partnership Model*, *supra* note 75, at 1424.

88. See *infra* Parts III.D.2 and III.E.

89. See, e.g., Gary S. Becker, *A Theory of Social Interactions*, 82 J. POL. ECON. 1063, 1079 (1974).

90. See, e.g., Apps & Rees, *supra* note 40, at 355 (noting that “[w]here policy based studies based on [a household utility function that is that of the head of the household] require specific assumptions about the intra-household distribution of welfare, the common practice is to assume they are all equally well off”).

91. See, e.g., *id.* at 357-61; Pierre-André Chiappori, *Collective Labor Supply and Welfare*, 100 J. POL. ECON. 437 (1992) (extending collective model); Pierre-André Chiappori, *Rational Household*

theories all allow a number of predictions that would be more difficult to obtain on the unitary model. In particular, individual-utility models easily predict that cross-elasticities of spouses' labor supplies—that is, the sensitivity of the labor supply of one spouse to the real wage of the other spouse—need not be symmetric.<sup>92</sup> Thus, as empirical work has confirmed, wives' labor supply decisions are relatively sensitive to the wage rate of their husbands—the higher the husband's wage, the less labor the wife will supply—whereas husbands' labor supply decisions are relatively unaffected by their wives' wage.<sup>93</sup> Additionally, the sensitivity of the labor supply of married women, particularly those not now working, to the wage rate they face themselves is far higher (though estimates vary) than the sensitivity of married men's labor supply to their own wage rates.<sup>94</sup> A lowering of the wage, which can result from a higher marginal rate of income tax, will reduce a married woman's labor supply proportionately more than a lowering of the wage will tend to reduce a husband's hours of

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*Labor Supply*, 56 *ECONOMETRICA* 63 (1988) (introducing "collective" model); Shelly Lundberg & Robert A. Pollak, *Separate Spheres Bargaining and the Marriage Market*, 101 *J. POL. ECON.* 988 (1993) (using "uncooperative" marriage model); Marilyn Manser & Murray Brown, *Marriage and Household Decision-Making: A Bargaining Analysis*, 21 *INT'L ECON. REV.* 31 (1980) (using Nash cooperative model assuming that household maximizes product of members' utilities in excess of reservation utility obtainable through divorce); Marjorie B. McElroy & Mary Jean Horney, *Nash-Bargained Household Decisions: Towards a Generalization of the Theory of Demand*, 22 *INT'L ECON. REV.* 333 (1981) (using Nash cooperative model); Pierre-André Chiappori, Bernard Fortin & Guy Lacroix, *Household Labor Supply, Sharing Rule and the Marriage Market* 1 (Nov. 1997) (unpublished manuscript, *Workshops in Applications of Economics*) (deriving predictions for sharing and marriage market from collective model).

92. See, e.g., MARK R. KILLINGSWORTH, *LABOR SUPPLY* 36 (1983). In the individual-utility models, cross-substitution effects arise as indirect income effects. See *id.* at 36-37.

93. See, e.g., *id.* at 109, 122-23 (collecting "first generation" studies and noting that the results support a cross-substitution elasticity for husbands that is not significantly different from zero, but wives' cross-substitution elasticity is usually significantly positive and in the range of 0.000 to 0.400).

94. See *id.* at 106-09 (discussing compensated own-substitution labor supplies of women and men), 192-206 (collecting "second-generation" studies and noting that they support an even greater difference between women's compensated own-wage labor-supply elasticities and married men's than did first-generation studies). See also MCCAFFERY, *supra* note 2, at 260-62 (collecting studies); Richard Blundell, *Labor Supply and Taxation*, in *THE ECONOMICS OF TAX POLICY* 107, 116-23 (Michael P. Devereux ed., 1996). Because estimates of labor-supply elasticity vary and are subject to methodological qualifications, it is hard to say how great the difference is between married men and married women. See Thomas A. Mroz, *The Sensitivity of an Empirical Model of Married Women's Hours of Work to Economic and Statistical Assumptions*, 55 *ECONOMETRICA* 765, 795-96 (1987) (noting wide range of estimates and problems with some studies). Even those who criticize some of the elasticity studies do seem to agree that elasticities for married women not already at work are particularly high. See, e.g., Killingsworth & Heckman, *supra* note 8, at 185-97; Mroz, *supra*, at 795. Cf. NADA EISSA, *TAXATION AND LABOR SUPPLY OF MARRIED WOMEN: THE TAX REFORM ACT OF 1986 AS A NATURAL EXPERIMENT* 31 (National Bureau of Econ. Research Working Paper No. 5023, 1995) (noting that for high-income wives, the decision whether to work outside the home is only slightly more elastic than the market-hours decision).

work (who may even work more if the income effect dominates the substitution effect).<sup>95</sup> Although more difficult to study, it seems particularly likely that the impact of the own-wage rate on the decision of *whether* to work in the marketplace at all is much higher for married women than for married men.<sup>96</sup> Thus, when it comes to the behavioral effects of taxation and their associated welfare losses, the effects of the tax system on married women will be more important than those on married men.<sup>97</sup>

Another simplifying assumption often made in models of the household is that households or their members choose between market labor (used to purchase market goods) on the one hand and “leisure” on the other.<sup>98</sup> It is true that this assumption of a choice between market labor leading to purchases of consumer goods versus enjoyment of leisure applies to all households and is not unique to the marital context. But this assumption nonetheless does have a large impact on the model of marriage and labor supply. By treating all nonmarket labor as consumption of leisure, the secondary earner is treated as making a decision between these two, rather than between *different forms of work*, as is often the case. While it is true that we can redefine “leisure” to mean all nonmarket activity, this provides little insight into the trade-offs between different nonmarket activities and between those different nonmarket activities and market-labor supply.

To remedy this problem it is necessary to disaggregate nonmarket-labor activities. Thus, we must adopt something along the lines of Gary Becker’s time-allocation model, in which labor supply and consumption decisions are broken down such that the things to choose among and upon which utility depends directly are not market goods and services but activities, or ways to spend time (“commodities” in Becker’s original terminology).<sup>99</sup> Crucially, individuals choose to consume or produce these “commodities.” To produce them, the individual uses as inputs her own time and market goods (or services). This production is captured by household production functions, the key innovation of Becker’s approach.<sup>100</sup> The time-allocation approach has proven more useful when

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95. See KILLINGSWORTH, *supra* note 92.

96. See *id.* at 442; sources cited *supra* note 94. Studying the participation decision is somewhat more difficult than the decision on how many hours to work, because data on the wage rate facing those who are not working is more difficult to obtain.

97. See *infra* Part III.D.

98. See, e.g., KILLINGSWORTH, *supra* note 92, at 1-28; WALTER NICHOLSON, MICROECONOMIC THEORY: BASIC PRINCIPLES AND EXTENSIONS 737-59 (6th ed. 1995).

99. See Gary S. Becker, *A Theory of the Allocation of Time*, 75 ECON. J. 493, 495-500 (1965).

100. See *id.* at 496.

there is a need to analyze nonmarket production (as opposed to market production).<sup>101</sup> Because nonmarket production and even nonmarket exchange is crucial in what follows, the time-allocation approach will be a natural place to start the efficiency analysis.

In the following discussion, it will be important to distinguish not only nonmarket production from "leisure," but also gift-giving or altruism from marital exchange. Income-splitting could occur for either or both reasons. If the primary earner derives utility from the secondary earner's enjoyment of resources, then the primary earner can gain utility by sharing with the secondary earner altruistically. The more utility the primary earner derives from the sharing, the more the utility-maximizing primary earner will share. As is often noted, there is nothing in the utility-maximization model that precludes altruistic preferences.<sup>102</sup> On the other hand, even a primary earner not so altruistically inclined might engage in a (nonmarket) exchange with the secondary earner. For instance, the husband will share income in return for the domestic labor of the wife. As mentioned earlier, for both feminist and efficiency reasons, we must be careful not to let the tax system increase the attractiveness of such an arrangement relative to a no-tax world. Both joint filing and even individual filing allow nonmarket marital exchange to escape tax altogether.<sup>103</sup>

#### 4. *An Analysis of Income-Splitting as Gift and Exchange*

Marital sharing can be regarded as gift-giving and exchange. Although gifts and exchanges are treated quite differently under the Internal Revenue Code, purely altruistic gift-giving and completely hard-nosed exchange are more realistically regarded as forming two poles of a continuum. Indeed, to French sociologist and anthropologist Marcel Mauss in his famous 1925 cross-cultural analysis of the institution of gift-giving, the essence of gift-giving is the indefinitely continuing cycle of gift, return gift, and counter-return gift.<sup>104</sup> Mauss found that what previous anthropologists had described as voluntary, spontaneous, and disinterested gift-giving with no expectation of return was actually quite the opposite.

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101. See KILLINGSWORTH, *supra* note 92, at 40; Reuben Gronau, *Leisure, Home Production and Work—The Theory of the Allocation of Time Revisited*, 85 J. POL. ECON. 1099 (1977).

102. See BECKER, *supra* note 35, at 277-306 (analyzing altruism within family); Gary S. Becker, *A Theory of Marriage*, in ECONOMICS OF THE FAMILY: MARRIAGE, CHILDREN, AND HUMAN CAPITAL 299, 327-32 (Theodore W. Schultz ed., 1974) [hereinafter ECONOMICS OF THE FAMILY] (introducing "caring" into the model of marriage).

103. See *infra* Part III.D.1

104. See MARCEL MAUSS, THE GIFT: THE FORM AND REASON FOR EXCHANGE IN ARCHAIC SOCIETIES 1-5 (W.D. Halls trans., Norton ed. 1990).

Mauss believed that gift-giving could constitute a very special form of relationship-building exchange—a “total social phenomenon” in Mauss’ terms—involving three mutually reinforcing obligations of giving, receiving, and repaying.<sup>105</sup> In any event, gift-giving can range from unconditional to quite conditional (Mauss’ systems), to pure exchange with no “gift” element at all.<sup>106</sup>

Although such a spectrum seems quite plausible, both the Internal Revenue Code and the law generally tend to classify transfers either as gifts or exchanges. Importantly, the rules that apply to gifts and those that govern exchanges are very different, and the classification thus carries with it often dramatic consequences. Thus, in property law the criteria for a valid gift are different from the requirements for an enforceable agreement in contract law. Contract law generally excepts donative promises from legal enforcement under the doctrine of “consideration.”

Sharing of income within a marriage can be analogized to gifts and exchanges. In a marriage, the husband and wife exchange a variety of services and property.<sup>107</sup> Many of these services bear a somewhat misleading resemblance to imputed income. These services, when performed for oneself, are imputed income. However, if they are performed for another in exchange for income they are *not* imputed income. If, on the other hand, the services are “donated” to the other spouse, they can be thought of as a gift of imputed income. As is well known, imputed income is not taxed for various reasons, including administrative difficulties and popular perceptions.<sup>108</sup> Maritally exchanged domestic services are also not taxed and this nontaxation contributes to a false similarity between such services and true imputed income.

Taking the gift analogy first, if we focus on “regular” income and its uses, we could treat the contribution of income by one spouse to the other like a gift. I do not mean that such a transfer really *is* a gift, and, as mentioned, the secondary earner may well be providing services to the house-

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105. *Id.* at 1.

106. For more recent treatments of the shading of gifts into exchanges and its relevance to the law, see, e.g., Jane B. Baron, *Gifts, Bargains, and Form*, 64 IND. L.J. 155, 180-81, 189 (1989); Melvin Aron Eisenberg, *The World of Contract and the World of Gift*, 85 CAL. L. REV. 821, 841 (1997); Carol M. Rose, *Giving, Trading, Thieving, and Trusting: How and Why Gifts Become Exchanges, and (More Importantly) Vice Versa*, 44 FLA. L. REV. 295, 302 (1992).

107. Dependents change the situation as between the spouses only if one spouse is taking greater financial responsibility for the child. See *infra* Part V.

108. See *supra* notes 7, 20, and accompanying text.

hold in return for financial security.<sup>109</sup> This should come as no surprise, because the notion of gift-giving itself is not incompatible with mutual transfer; indeed, cross-culturally, many long-term gift-giving relationships may best be seen as protracted exchange relationships, as Mauss would recognize. There is little reason to think that analyzing marital sharing as gift-giving implies a one-way street.

Instead, the analysis in terms of a gift will serve two purposes. First, granting that the view of marital sharing as a gift quite often exaggerates the contribution of the primary earner, we should be careful to prevent the Code from treating the primary earner *even better still*. In other words, the Code should not treat the primary earner as conferring an even larger gift than even the rosiest view of the sharing would justify.

Of equal importance is the fact that analyzing marital sharing as gift-giving furnishes some insight into the assumptions lurking behind treatments of the income-splitting problem that do not tax imputed income (or domestically traded services). That is, even granting that some mismeasurement will flow from the nontaxation of imputed income, we can use the gift analysis to discover which approach to “taxable well-being” motivates the Code’s approach to family taxation and the various suggested alternatives.<sup>110</sup>

When *A* gives value gratuitously to *B*, there are three possible approaches to taxing the transfer. First, the donor could receive a deduction for the amount donated and the donee would pay tax. Second, both the donor and the donee might be taxed on the transferred amount. Or, third, the donor but not the donee might be taxed on the amount.

The first possibility, taxing the donee but not the donor, corresponds to a “standard-of-living” approach to measuring income.<sup>111</sup> Consider two parent-child pairs *A-A'* and *B-B'*. *A* and *B* start off with the same wealth but *A* saves and makes a bequest to *A'*. *B* consumes her wealth. The children consume everything they have. On a “standard-of-living” measure, the pairs should pay roughly the same tax, because *A'* is just consuming what *A* did not consume.<sup>112</sup> *A* should pay less tax and *A'* should pay higher tax.

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109. See Baker, *supra* note 38, at 1206-13 (analyzing marriage as involving a bargain of services for financial security).

110. Later on, we will be in a better position to understand what approaches to measuring income are implicit in the various splitting proposals.

111. See DAVID F. BRADFORD, BLUEPRINTS FOR BASIC TAX REFORM 33-35 (2d ed. rev. 1984) (reprint of UNITED STATES DEP'T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM (1977)).

112. See *id.* at 34.

The “ability-to-pay,” or what I will term the “strong-control” view, would lead to taxing *A* as well as *A'* on the amount *A* transfers to *A'*, because the gift itself is an exercise of the ability to pay.<sup>113</sup> *A'* also has an ability to pay greater than that of *B'* corresponding to the value of the gift *A'* receives from *A*. On the ability-to-pay approach, the pair *A-A'* should pay more tax than the pair *B-B'*.

The treatment of gifts under current tax law exemplifies the third approach, taxing the donor but not the donee.<sup>114</sup> As between the pairs *A-A'* and *B-B'*, this corresponds to a “rough” reverse standard-of-living approach, because like the straight standard-of-living measure, it taxes the pairs *A-A'* and *B-B'* equally, ignoring for the moment the effects of progressive rates. But, unlike the straight standard-of-living approach, the reverse standard-of-living treatment of the pairs mismeasures the standard of living of the members of each pair, because the donor pays tax on more than she consumes and the donee pays less.<sup>115</sup>

Alternatively, this treatment of the donor-donee pairs under the Code can be regarded as a “weak-control” approach to the taxation of gifts. Under what I term the “weak-control” approach, the donor is regarded as exercising an ability to pay, but the donee is not.<sup>116</sup> By contrast, under Henry Simons’ view (the “strong” view), we would find control (and a corresponding increase in ability to pay tax) in both the donor and the donee.<sup>117</sup> The strong- and weak-control theories diverge in the consequences for the donee: Does the donee have “control” over the resources after the gift and a corresponding ability to pay tax? Although it is true that we may have more assurance of control on the part of the donor—after all, the donor chose to make the gift—it seems likely that donees have “control” in a good many cases. Thus, to the extent that the Code’s provisions on gifts are motivated by policy, the Code either reflects a rough reverse standard-of-living approach or a “weak-control” theory of ability to pay. And, given the closeness of the many policy choices—two versions of control versus consumption, ability to pay versus two versions of standard of living—it may be that the relative administrative ease of taxing donors over taxing donees is the decisive reason for the present system of only taxing

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113. *See id.*

114. Section 61 of the Internal Revenue Code defines gross income broadly and § 102 provides that gross income does not include value of property acquired by gift, bequest, devise, or inheritance. *See* I.R.C. §§ 61, 102 (1994).

115. *See* BRADFORD, *supra* note 111, at 34.

116. Zelenak seems to subscribe to the weak approach in his discussion of control and consumption within marriages. *See* Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 357-58.

117. *See* HENRY C. SIMONS, *PERSONAL INCOME TAXATION* 125-47 (1938).

donors. It would not be entirely surprising to find that the Code is an uneasy compromise between a dominant ability-to-pay theory based on control<sup>118</sup> and some form of standard-of-living theory based on consumption lurking in the shadows.

On the analogy to gift-giving, income-splitting can be viewed as the transfer of one half of the increment of the primary earner's income over that of the secondary earner.<sup>119</sup> Assume for the moment only earned income (ignoring for now income from property), and consider two sets of spouses. *A* earns \$100 and *A'* earns \$50. *B* and *B'* each earn \$75. Income-splitting is like a transfer of \$25 ( $= (\$100 - \$50) / 2$ ) from *A* to *A'*. On the three approaches to taxing transfers, one could tax *A'* but not *A* on the \$25 transferred, tax both, or tax *A* but not *A'*. The first is the income-splitting result that conventional joint filing leads to, and, as we have just seen, it corresponds to the straight standard-of-living measure of income. Thus, conventional joint filing seems to rely implicitly on the standard-of-living approach.

This in itself is quite interesting, because the income tax is generally thought to reflect an ability-to-pay theory. Thus, we have already shown that viewing the spouses in a married couple as individuals reveals joint filing as an *exception* to the Code's general approach.

The treatment that does correspond to the ability-to-pay or strong-control view is the "double-taxation" variant, under which *A* would pay tax on \$100 and *A'* would pay tax on \$75 ( $= \$50 + \$25$ ). In other words, both would pay tax on half the increment of the primary earner's income over that of the secondary earner (here \$25). The primary earner is exercising the ability to pay by transferring wealth to the secondary earner, who, as a result, has an increased ability to pay. This "double" method of taxing gifts was advocated by Simons outside the marital context<sup>120</sup> but has not found many adherents.

The last approach would tax the primary earner on his or her full income but not the secondary earner on the amount transferred. This would be in accord with current law preventing assignments of earned income from affecting choice of taxpayer,<sup>121</sup> and it is also the method used for

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118. The concept of income itself is usually regarded as incorporating a view that taxation should follow ability to pay. This theory is implemented by looking to control to find income (and hence ability to pay). See generally GRAETZ & SCHENK, *supra* note 32, at 31.

119. Later I will consider the implications of taking a more realistic view of the amount of sharing that really takes place. See *infra* Parts II.C and V.

120. See SIMONS, *supra* note 117, at 125-47.

121. See *infra* Part IV.

treating gifts under the current income tax, which corresponds to the rough reverse standard-of-living measure or, alternatively, the weak-control theory.<sup>122</sup> Such double taxation (of both donor and recipient) might be viewed as protecting progressivity, since an earner cannot shift income to another individual in a lower bracket. But it only does so at the price of some mismeasurement of income on the standard-of-living approach, or it requires us to adopt the less plausible weak, as opposed to strong, theory of control. Individual filing thus reflects the rough reverse standard-of-living or the weak-control measures of income.

With a few possible exceptions,<sup>123</sup> most commentators do not advocate an explicit marriage penalty. For present purposes, I interpret “marriage penalty” to mean any increment in taxes for a married individual over what that person would owe as a single individual with the same income. Whether or not this is really a penalty certainly depends on whether or not the benefits of marriage outweigh the burdens. As a first approximation, I will assume that they do, since some people do become and stay married, although the costs of getting divorced are a factor once people are married.

On a standard-of-living measure that takes into account all aspects of individual utility, we would expect a higher tax on married couples. However, since the added benefit comes from nonmonetary transfers, consumer surplus, and “economies of scale,”<sup>124</sup> measuring standard of living in a marriage by household monetary income will not lead to this result. On the other hand, the ability-to-pay measure focuses on the monetary transfer and suggests ability to pay in the primary earner corresponding to that of a single individual with the same income, and an ability to pay in the secondary earner corresponding to the sum of the transferred amount and any other income earned by the secondary earner. This would drive the income for tax purposes higher relative to the income of two corresponding singles earning the same respective amounts.

Individual filing corresponds to the rough reverse standard-of-living measure or the “weak-control” version of the ability-to-pay approach in the area of gifts. Separate filing would tax the primary earner, but not the secondary earner, on any extra income shared with the secondary earner. If sharing is occurring, then the secondary earner’s standard of living is

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122. See BRADFORD, *supra* note 111, at 34-35.

123. See *infra* Part III.D.1.

124. As discussed above, many of these so-called “economies of scale” are best analyzed as something else, such as public goods within the marriage. See *supra* notes 18-20 and accompanying text.

underestimated. Separate filing would not lead to a marriage (or singles) penalty, unless intrafamily gifts additionally were taxed to the donee (which they are not).

Joint filing with full income-splitting corresponds to the standard-of-living measure, as seen earlier. If the couple is taken axiomatically as the unit for calculating utility, then this measure has some initial plausibility, but the assumption that the family is the relevant unit for calculating utility is itself problematic.<sup>125</sup>

Furthermore, we should be concerned about the distribution of utility *within* the marriage and the incentives on the individual that taxing it (or not) creates. If so, then the case for income-splitting is far less clear. In addition to the well-known disincentive for the secondary earner to work, we may ask whether as much wealth—or more accurately, as much wealth as would be a good index to well-being—is really being transferred as is implied by income-splitting under joint filing. If half the increment of the primary earner's income over the secondary earner's income were really a gift with nothing in return, full splitting would be consistent with viewing the transfer as a gift.

But there is good reason to believe that half the increment is *not* a pure gift. The primary earner may enjoy a degree of control and power that makes the transfer less than complete.<sup>126</sup> Thus, on full splitting, the donee/secondary earner's income comes out too high and the donor/primary earner's income is treated as too low. The secondary earner as an individual thus faces a marriage penalty. In sum, even on a very rough scale, it is doubtful that either individual filing or full splitting necessarily captures the standard of living *or* the ability to pay of the individuals in the marriage.

Now consider the possibility of an exchange within the marriage of services for income. Many commentators have pointed out that what occurs in a marriage is better likened to a (nonmarket) exchange rather than to a gift, and an entire "exchange theory" of marriage and many other social relations has developed within sociology and only more recently in economics.<sup>127</sup> Keeping in mind that gifts and exchanges form a contin-

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125. See Hurley, *supra* note 2, at 168-80.

126. See *supra* Part II.A.2 and *infra* Part IV.A.4.

127. For a discussion of the "exchange theory" in the sociology context, see, e.g., PETER M. BLAU, EXCHANGE AND POWER IN SOCIAL LIFE 88 (1964); LETHA SCANZONI & JOHN SCANZONI, MEN, WOMEN, AND CHANGE: A SOCIOLOGY OF MARRIAGE AND FAMILY 10-11 (1976); Note, *supra* note 23, at 373-76 (surveying exchange theory literature in relation to marital income pooling). For a study that incorporates marital exchange of spousal labor in Gary Becker's marriage market framework, see

uum, these commentators can be regarded as arguing that the flow of services, property, and money-income within marriages falls further towards the exchange end of the spectrum than is commonly thought. Some may object to the label “exchange” in the context of marriage, but when it comes to analyzing the behavioral effects of taxation on the couple, it is worthwhile to consider the possibility of an exchange-like relation.

In an ordinary exchange, the Internal Revenue Code taxes both participants. If *A* purchases a haircut from *B*, *A* pays *B* for the haircut out of after-tax income because there is no deduction for the cost of the haircut; even if it were necessary to *A*'s job to have short hair, the haircut would invariably be found inherently personal and thus nondeductible.<sup>128</sup> The provider of the service is taxed on the income (the gross receipts minus costs) derived from the transaction. Thus in the haircut example, *B*, the barber or stylist, would be taxed on what *A* paid minus the costs of doing business. Marital exchange, by contrast, is not taxed: The provider of the services is not taxed.<sup>129</sup> But it will be worthwhile to consider how marital exchange would be taxed if it were treated like a market exchange.

In the marital context, if the primary earner can “share” income with the secondary earner in return for domestic services, then the Internal Revenue Code's treatment of exchanges would, if it applied, dictate taxing the primary earner on the income and taxing the secondary earner on the receipt of the shared income. This looks very much like Simon's double-taxation approach to nonmarital gifts discussed earlier.<sup>130</sup> A natural question arises about the costs of rendering the services. Because the domestic labor is done both as a self-rendered service for the secondary earner herself and as a service for the primary earner, the costs would be partly personal and partly “business.” One might object that any service for the couple is personal, but the danger here is to fall into the assumption that the couple (as a unity) is the only experiencer of utility. In examining the exchange analogy it is far from clear that the unitary model is appropriate.

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SHOSHANA GROSSBARD-SHECHTMAN, ON THE ECONOMICS OF MARRIAGE: A THEORY OF MARRIAGE, LABOR, AND DIVORCE 25-83 (1993).

128. Section 262 disallows any deduction for “personal, living, or family expenses.” I.R.C. § 262 (1994). Clothing, personal grooming, and the like are deemed “inherently personal” even when the taxpayer can point to a business necessity for the item. *See, e.g., Pevsner v. Commissioner*, 628 F.2d 467 (5th Cir. 1980) (denying deduction for Yves Saint Laurent clothing for a taxpayer who was a store manager required to wear the expensive clothing on the job but who never wore it after-hours because, according to the taxpayer, it was too extravagant for her lifestyle). *See generally* GRAETZ & SCHENK, *supra* note 32, at 70-71.

129. The recipient of the services—the transferor of the cash—gets no deduction and so pays out of after-tax income, as in the market case.

130. *See supra* text accompanying note 120.

On the other hand, to the extent that some of the costs are public goods or give rise to a personal benefit to both spouses individually, any deduction of items by the secondary spouse would be an inappropriate deduction of personal expenses. Furthermore, because many expenses of working in the marketplace—grooming, working clothes, commuting—are deemed inherently personal under current law,<sup>131</sup> deductions for “business expenses” in the home-labor context would lead to even more of a tax-favored status for domestic labor than under current law. I return to these questions in Part III.E below.

Neither joint nor individual filing treats marital sharing as it would a market exchange. Under joint filing, only the recipient spouse in effect is taxed on the shared income. The sharing lowers the couple’s rates further below what the primary earner would face as an individual and raises it further above what the secondary earner would face as an individual. With individual filing, the primary earner is taxed on the shared income but the recipient spouse is not. Thus, the domestic services are paid for out of after-tax dollars but the income earned (in the form of “shared” income) in return for the domestic services is not taxed to the wife.

Commentators often lump this under the heading of “imputed” income and invoke the impossibility of taxing imputed income as a justification for not worrying further about the incentive effects. Even those writing from a feminist point of view usually stop at advocating individual filing (to solve the stacking problem) without worrying much whether we are *still* favoring domestic labor over market labor of women and what might be done about it. Especially if the wife is exchanging domestic labor for shared income in a nonmarket transaction, it is likely that this way of earning income will be a close substitute for market labor. If so, then the unequal tax treatment of labor in a market exchange and in a marital exchange, with the latter heavily favored, can be expected to induce a shift towards domestic labor by women even under individual filing.

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131. Even commuting expenses that would not arise but for job requirements have been held to be inherently personal. *See, e.g.*, *McCabe v. Commissioner*, 688 F.2d 102 (2d Cir. 1982) (denying deduction for extra gas and toll expenses to a New York City policeman who lived in New York State and was required to carry his gun at all times but could not get a gun permit in New Jersey even though he needed to drive around New Jersey to commute to work); *Treas. Reg. § 1.162-2(e)* (1960) (stipulating commuting expenses as nondeductible); *Rev. Rul. 75-380*, 1975-2 C.B. 59, 60 (allowing deduction only for additional commuting expenses necessary to get work implements to and from work, and giving an example where only the cost of renting a trailer to carry tools but not extra gas would be deductible). *See also* *Commissioner v. Flowers*, 326 U.S. 465 (1946) (denying deduction to taxpayer who commuted from Jackson, Mississippi, and worked in Mobile, Alabama). *But cf.* *Pollei v. Commissioner*, 877 F.2d 838 (10th Cir. 1989) (allowing deduction for commuting expenses for police officers who were engaged in their jobs while driving to and from the stationhouse).

Thus, if marital sharing is more like a gift, individual filing accords with the current tax treatment of gifts, but joint filing reflects a very plausible approach to gifts, the standard-of-living approach. Indeed, since the reason for taxing gift-givers but not recipients under the Code may be a practical rather than policy-based one, joint filing *cannot* be said to be inconsistent with marital sharing as a gift. If, on the other hand, marital sharing is regarded as part of an exchange, then neither individual nor joint filing treats sharing appropriately. Even individual filing, heavily favored by those concerned with women's incentives to work outside the home, treats marital exchange far more favorably than labor by a secondary earner in the marketplace.

### C. JOINT AND INDIVIDUAL FILING AND "MARRIAGE NEUTRALITY"

Because rhetoric does not always match reality and because people tend to deceive themselves and others about their true level of support for sharing, there is a gulf between normative and descriptive models of marriage. It is generally believed that tax law can do little to move us toward equal-sharing marriages and we therefore must choose a tax law that reflects the nonsharing reality—namely, individual filing. This conclusion is too hasty.

Individual filing leads to couples with the same household income paying different tax. As we will see, this may not be so problematic if the different tax on those couples reflects genuine differences between them in the degree of sharing. Because individual filing does not calibrate tax to the amount of sharing, for the most part it is unlikely that individual filing makes sensible distinctions among couples. Joint filing, on the other hand, leads to a singles penalty if couples are in effect permitted to each pay half the tax on total household income at singles rates (by doubling the size of the brackets). I will call this "pure" joint filing.<sup>132</sup> A different "harsh" form of joint filing applies the singles rates to total household income as if only one spouse earned it all. Such a system leads to steep marriage penalties. The present system combines a bit of both pure and harsh joint filing, because it features special rates that lead to a marriage penalty for some and a marriage bonus for others.<sup>133</sup> That is, some people pay more tax than they would collectively as two singles and some couples pay less than they would outside marriage.<sup>134</sup>

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132. Unless otherwise indicated, I use the term "joint filing" to mean pure joint filing.

133. See *supra* note 9.

134. For data on the present system, see CONGRESSIONAL BUDGET OFFICE, *supra* note 10, at 24.

Both the stacking effect and the marriage penalty under current joint filing are generally thought to be significant at all income levels. For those who face the penalty at the lowest income levels, the marriage penalty stemming from the phase-out of the Earned Income Tax Credit is likely not to push women out of the labor force because women's earned income is so needed, but rather to exert a pressure in favor of not being married.<sup>135</sup> For middle-income women, the "stacking" effect from the joint return makes working outside the home less attractive,<sup>136</sup> and for those upper-income women who are secondary earners, the stacking effect is thought to be significant.<sup>137</sup>

Based on the spectrum of marriages from those involving little sharing to those that are quite sharing, we should be skeptical that either joint or individual filing (or the present system) takes sharing adequately into account. If sharing is relevant to the proper tax treatment of couples, then neither one-size-fits-all system is likely to be satisfactory: Neither joint nor individual filing reflects the degree of sharing in the full range of marriages, and neither does anything to enforce the degree of sharing they presuppose.

### III. A RATIO FOR MARITAL INCOME-SPLITTING

I turn now to a system for determining how much income-splitting to allow that reflects sharing. Examining how such a system would work serves as an analytical tool to see the role that sharing plays in the choice of whom to tax. Any ratio based on actual sharing appears to pose tremendous problems of measurement and significant incentives to overreport sharing. However, a self-assessment mechanism that ties the ratio of splitting for income-tax purposes to the ratio used for splitting property (broadly defined) on divorce can solve these and a variety of other problems as well.

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135. See, e.g., MCCAFFERY, *supra* note 2, at 83-84, 194; Zelenak, *Tax and the Married Woman*, *supra* note 67, at 1023, 1040-41.

136. See, e.g., MCCAFFERY, *supra* note 2, at 150-54. That these behavioral effects are substantial is not a universally held view. On why intermediate filing meets some of the skepticism about these behavioral effects, see *infra* Part III.D.4.

137. See, e.g., MCCAFFERY, *supra* note 2, at 154-59. Many upper-income women may not be secondary earners, which may explain why many of them have jobs in the marketplace despite the severity of the stacking effect. See Zelenak, *Tax and the Married Woman*, *supra* note 67, at 1023 & nn.12-13. Also, some high-income women may work in the marketplace for nonmonetary reasons. See MCCAFFERY, *supra* note 2, at 159.

## A. FRACTIONAL SPLITTING

Ideally, we might like to allow splitting to the extent that the spouse with fewer resources really has control. That is, we would measure sharing within a marriage and allow income-splitting on the basis of how much actual sharing is occurring. However, control and sharing are virtually impossible to measure, and legal relations may not give a good picture of who really controls the resources in a family. As we will see, tax law has long included a “control” test but one based on a very different and far less adequate notion of *legal* control.<sup>138</sup> A spouse can have a legal right to control and not exercise it, and, more importantly, legal control as currently defined need not have long-term bite. Even in community property, there is no assurance of longer-term control by any given spouse because property can be labeled “community property” but subsequently transmuted back to separate property.<sup>139</sup>

To allow splitting on the basis of the amount of sharing is a form of fractional splitting, because the sharing may fall anywhere on the spectrum from no sharing to full sharing. We might ask whether to allow fractional splitting on the basis of legal support obligations: The lower-earning spouse would be taxed an amount corresponding to what the higher-earning spouse could be required to provide as support.<sup>140</sup> The problem with using legal support obligations in this manner is that more or less sharing may take place than is legally required.<sup>141</sup> Furthermore, legal support obligations are very minimal and less than adequate to protect the secondary earner’s legitimate expectations of benefit from marriage.<sup>142</sup> Support obligations therefore are quite inaccurate as a proxy for the degree of sharing occurring in more-than-minimally sharing marriages. Also, as we will see, a formula for income-splitting based on a view of minimal sharing does little to *encourage* the level of sharing that remains the ideal that motivates income-splitting proposals in the first place.

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138. See *infra* Part V.A.1.

139. See *infra* Part V.A.2.

140. Boris Bittker notes this possibility in passing. See Bittker, *Taxation and the Family*, *supra* note 2, at 1422. For further discussion of why this would not be as desirable as the intermediate-filing system proposed here, see *infra* Part V.B.

141. The purpose of alimony was to maintain the marital standard of living in two households to the extent possible, but alimony was neither generous nor easy to collect. See HOMER H. CLARK, JR., *THE LAW OF DOMESTIC RELATIONS IN THE UNITED STATES* § 16.4 (2d ed. 1987).

142. See Baker, *supra* note 38, at 1206-13, 1220-27 (criticizing current law as inadequate to protect women’s bargained-for expectation of security from marriage and proposing alternative contract-based measures).

Using legal support obligations as a basis for fractional income-splitting is a lot like using the category of community property itself. Both support obligations and the community-property classification are theoretically about how to divide assets and income on divorce, but both are not necessarily a good guide to sharing and control in a marriage. The legal title and right to control in community-property or common-law regimes do not necessarily reflect the real control or power and consumption patterns within the marriage.

I argue that asking what existing family law or property law category may serve as the basis for income-splitting is backwards. Rather than facing the inadequate menu of choices from family law and property law, we may turn the inquiry around: How do we ensure that a basis for the income-split for tax purposes is respected for other purposes such that splitting will reflect sharing?

#### B. A SELF-ASSESSED RATIO

Instead of allowing splitting to the extent of legal support obligations, we would do better to ensure that the amount used for income-splitting in the tax area is really shared. I propose a system of individual filing with the opportunity to opt into any degree of splitting, subject to possible limits.<sup>143</sup> If couples did nothing, they would be subject to individual filing, and I return to exactly what this would entail in Part III.F below.<sup>144</sup> For now, I will concentrate on couples who opt out of individual filing and into some degree of income-splitting.

The degree of splitting would depend on a ratio negotiated by the spouses that would govern not only income-splitting for taxation but also property division on divorce. Thus, if the ratio negotiated were 50/50, then half the total household income would be taxed to each spouse, and they would enjoy full splitting of both income from services and income from property. On divorce, property, including the fruits of human capital, would also be divided 50/50.<sup>145</sup> If, on the other hand, the couple negotiated a 60/40 ratio, then the primary earner would be taxed on 60% of total

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143. On the possible limits, see *infra* notes 165-71 and accompanying text.

144. Along with most proponents of individual filing, I am assuming that the individual-filing default would use the same rates for married couples as for singles. No attempt is made here to provide for taxation of marital economies of scale. Cohabiting singles enjoy many of the same economies of scale, making special treatment in the case of married couples less desirable than it might have been in an earlier era. Modifications to the system proposed here could be made to reflect economies of scale if so desired.

145. Intermediate filing solves some of the well-known difficulties in handling human capital in the context of divorce. See *infra* Part III.E.

household income, and the secondary earner on 40%. This couple, and the primary earner in particular, enjoys less splitting but on divorce, property would be divided 60/40.

This self-assessed ratio system can be illustrated by a return to the familiar cases. In Cohen's Case 3, *C* and *C'* are married with *C* earning \$20,000 and *C'* earning \$0.<sup>146</sup> Now let us break this case into two scenarios. In the first, *C* shares control and consumption of \$10,000, and negotiates a 50/50 ratio under intermediate filing. This means that one half of the couple's total income is taxed to each spouse, and correspondingly, a 50/50 ratio will be used for property division on divorce. Now consider a second scenario in which *C* shares only \$8,000 with *C'* and negotiates a 60/40 ratio. With this ratio, intermediate filing will lead to taxation of \$12,000 to *C* and \$8,000 to *C'*, and this same 60/40 ratio would be used on divorce. Under progressive rates then, *C* in the scenario with a 60/40 ratio of sharing and property division ratio faces a higher tax and a higher marginal rate than does the primary earner in the 50/50 scenario. Likewise, the 60/40 household pays more tax than the 50/50 household. But what if the less-sharing *C* of the second scenario negotiated a 50/50 ratio under intermediate filing? In that case, *C's* taxes would be lower but on divorce *C'* would get 50% of the property, including at least the fruits of human capital built up in either spouse during the marriage.<sup>147</sup> Furthermore, under a no-fault system, *C'* will always be free to walk away with the money. In effect, the intermediate-filing system would mandate that sharing actually occur if the couple as a whole, and the primary earner in particular, pays the lower tax associated with the ideal of greater sharing.

Notice that this treatment of Cohen's Case 3 makes sense when the unequally earning couple in Case 3 is compared with the equally earning married couple in Case 4 (*D-D'*, in which each earns \$10,000). In Case 4, *D* and *D'* can negotiate a 50/50 ratio. This case can be broken down into two scenarios as well. Assume first that *D* and *D'* share. Then they will negotiate a 50/50 ratio to govern taxation and property division on divorce. As far as sharing is concerned, they are similarly situated to *C-C'* in the first scenario above. The equal treatment of *C-C'* and *D-D'* under the sharing scenarios makes sense. Now consider a second scenario under Case 4 in which *D* has much more separate property than *D'* and has no intention of sharing it on divorce. In that case, *D* may well have to negotiate a less equal ratio, such as 60/40, and he will be taxed on 60% of all household income (both earned and property income); *D'* will be taxed

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146. See *supra* note 1 and accompanying text.

147. On human capital, see *infra* notes 244-53 and accompanying text.

only on 40%. *D* will face a higher marginal rate than he would have under either joint or individual filing, and the system will give *D* an incentive to share with *D'* in order to lower his average and marginal rates. Under joint filing, the split is mandated and extra sharing is not rewarded by lower taxes—there is no marginal benefit in taxation from more sharing with *D'*. Under individual filing, there is likewise no extra benefit of lower rates from sharing earned income with *D'*. With respect to property income, it is notoriously easy to make *D'* appear to be the owner of the asset (and hence taxed at lower rates) but let *D* retain actual ownership even on divorce.<sup>148</sup> Thus, *only* intermediate filing rewards extra units of sharing with extra lowering of taxes.

Some major advantages of intermediate filing are immediately apparent. Not only does the system use a reasonable proxy for sharing and more closely fits the “sharing” rationale for lower taxes in marriage, but it also gives the economically better-off spouse an incentive to share. Relations in the marriage, the distribution of power, and the incentives for investment all take place in the shadow of the divorce rules. How willing the wealthier spouse is to give up rights on divorce may be a rough proxy to how much power-sharing is going on.<sup>149</sup> Unlike with community property’s free transmutation rules, the spouse with more bargaining power cannot make side-deals to retain *de facto* control.<sup>150</sup> Such side-deals can be regarded as the sale of a tax-shelter opportunity.<sup>151</sup> Little or no sharing may be going on, but in order to lower his taxes, the primary earner can arrange—in return for some benefit to the secondary earner up to the amount of the tax advantage—for the fictitious appearance of ownership by the secondary earner.<sup>152</sup> This is not the type of marital sharing that is

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148. See *infra* Part V.A.

149. For a theoretical model from which one can derive this conclusion, see GROSSBARD-SHECHTMAN, *supra* note 127, at 54-83 (deriving the conclusion that factors that increase women’s “quasi-wage” for domestic labor are likely to increase women’s consumption, power, and control within marriage).

150. For example, the spouse with more bargaining cannot negotiate to get the other spouse to agree to transmute separate property into community property for a time and transmute it back at the end of five years. See *infra* Part V.A.

151. Although “abusive tax shelter” is a value-loaded term, it is generally appropriate where “any investment or transaction . . . produces a tax savings greater than that which would be appropriate given its economic income or loss.” GRAETZ & SCHENK, *supra* note 32, at 392. For famous examples of deduction-selling tax shelters, see, e.g., *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978) (use of sale-leaseback transaction in attempt to transfer deductions); *Estate of Franklin v. Commissioner*, 544 F.2d 1045 (9th Cir. 1976) (real estate tax shelter involving *inter alia* shift of depreciation deductions).

152. For example, if husband *H* faces a 40% marginal rate and his wife *W* faces a marginal rate of 20%, then appearing to share \$100 with *W* would save *H* \$20. *H* could pay *W* anywhere between \$0 and \$20 for this opportunity with the understanding that the income or property really remains his

supposed to happen in marriage, and the ostensible sharing is in such cases far less than actual sharing. Instead, such an arrangement bears a great resemblance to tax shelters that involve the sale of deductions.<sup>153</sup> In such cases of false sharing, the most income-splitting we should recognize for tax purposes would be the sharing of what I call the “tax-shelter fee.”<sup>154</sup>

By using the ratio across the board for both earned and property income alike, intermediate filing, like joint filing and unlike individual filing, also removes incentives to manipulate the appearances of ownership. The removal of the “tax-shelter” opportunities just noted would lead to greater equity between those with property income and those with earned income, with a corresponding efficiency advantage in removing the distortionary practice of favoring property income over earned income. By removing the incentive to manipulate the appearances of ownership, much greater simplicity can be achieved; there is no longer a need to protect against unfairness and revenue loss by waging a futile war against couples’ efforts to game the system. By contrast, individual-filing systems generally tax the owner of an asset, and enormous problems of revenue loss and unfairness result from the gamesmanship in the designation of asset ownership.

More generally, there is a sense in which the splitting ratio would *define* the rights of the spouses. An important element of each spouse’s individual ownership is what each spouse could take on divorce. The splitting ratio would then resemble the part of a partnership agreement that determines each partner’s share on break-up where, under the agreement, each partner has a unilateral right to terminate.<sup>155</sup> Although we could imagine

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(under his control). The more bargaining power *H* has, the greater the portion of the \$20 gain he will be able to capture. Also, there is some risk that *H* and *W* will divorce before the fake arrangement can be switched back. This risk will diminish the amount *H* is willing to pay, making *W* even worse off. Moreover, if legal trappings such as title can be switched easily, this is not an insurmountable problem to such arrangements. On the problem of “ingratitude” and defection, see *infra* Part VI.

153. Such a scenario gains further plausibility in light of anecdotal evidence that some two-earner couples are asking their tax preparers to calculate what each spouse would owe individually in order to divide refunds or to determine responsibility for underpayments. See Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 350 n.54 (citing Ellen E. Schultz, *How to Split the Tax Bill with Your Spouse*, WALL ST. J., Mar. 31, 1993, at C1). As Zelenak notes, such couples “are rejecting in the most radical way possible, the pooling assumption underlying the joint-return system.” *Id.* at 351 n.54. Couples who can go to such lengths can easily be imagined engaging in the tax-shelter games envisioned in the text.

154. Thus, in the example given *supra* in note 152, suppose that *H* pays a “fee” of \$7 to gain the tax advantage of \$20. We should count \$7, not \$20, as the amount shared. Respecting the outward forms of ownership in this case overstates sharing by \$13 or almost 200%.

155. The old Uniform Partnership Act reflected a stronger notion of unity of interests than does the Revised Uniform Partnership Act, which does not make all self-interested actions violations of fiduciary duty. See Kornhauser, *Partnership Model*, *supra* note 75, at 1420-21. Much of the criticism

additional rights to enforce a bargain without break-up, and although some value will be lost in a break-up, the right to take by calling for dissolution does strengthen the hand of the holder of that right.<sup>156</sup> A recent study described below suggests that increasing women's legal entitlement over monetary income increases their control and consumption within the marriage.<sup>157</sup> The proper comparison then is sharing of consumption without the right to take a corresponding proportional share of assets (including human capital) on divorce and the sharing of marital resources with such a right (as under intermediate filing). Thus, to a certain extent, each spouse's ownership rights would be determined by the agreed splitting ratio. Of course, because property law and family law are mostly matters of state law, some coordination between the federal and state levels may be required.<sup>158</sup>

Furthermore, if the fractional income-splitting applies to all marital income, both from services and from property, some troublesome aspects of current law may be avoided as well.<sup>159</sup> Even more problematic than transmutations in community-property systems are assignments of income from property that satisfy the formal requirements as transfers of property but that furnish no guarantee of a corresponding amount of actual sharing as the formalities would imply. We can solve this very thorny problem on the present proposal by aggregating all the couple's income from all sources and, for tax purposes, attributing it to the spouses according to the same prenegotiated self-assessed ratio. The holder of title and other such subtleties would make far less difference. As noted earlier, this would carry with it the major side benefit of reducing the incentive to engage in property-transfer gymnastics to effect income-splitting: The income from property would be subject to the same splitting ratio regardless of the formalities of ownership during the marriage. Again, the splitting ratio would serve to define ownership.

Setting up the ratio is not an idle exercise. The wealthier spouse is on notice that the more favorable a ratio she chooses for income-splitting, the more the other spouse could unilaterally take by ending the marriage. In

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of family law has centered on the largely immutable character of the partnership-like rules in the marital context. On the default nature of intermediate filing, see *infra* Part III.F.

156. For an analysis of why the tendency has been away from limiting the remedy to dissolution in some areas of the law but not in family law, see generally Saul Levmore, *Love It or Leave It: Property Rules, Liability Rules, and Exclusivity of Remedies in Partnership and Marriage*, 58 *LAW & CONTEMP. PROBS.* 221 (1995).

157. See *infra* note 176 and accompanying text.

158. I return to this question in *infra* Part III.E below.

159. See *infra* Parts IV and V.

the context of no-fault divorce, the choice of ratio is thus subject to countervailing pressures; the wealthier spouse has an incentive not to make the ratio any more favorable than she finds comfortable allowing the other spouse power to use on a unilateral divorce. Additionally, since making the ratio more equal between the spouses is giving up this power, it may be a fair proxy for sharing in the marriage.<sup>160</sup> In any case, the wealthier spouse knows that she will pay if she gets it “wrong.”

In this respect, the proposed system is somewhat like a scheme for self-assessment.<sup>161</sup> In self-assessment, a person is asked to put a value on something and that value will be used for two purposes. For one purpose, a low valuation is advantageous to the self-assessor. However, with respect to a second purpose, a high valuation benefits this same person. The prospect of the second use of the self-assessed value provides a countervailing incentive to the motivation to underreport. For example, consider a scheme of property-value assessment in which a homeowner can set the valuation for taxes as long as he knows that valuation could be used in a government taking or in some other kind of forced sale. In some such self-assessment systems, nongovernmental “assessors” could force the property owner to sell at the self-assessed price. If the taxpayer sets the value too low, the government will win by engaging in a cheap taking or a forcing buyer (one of the nongovernmental assessors) will buy the property at the cheap self-assessed price.

The present income-splitting proposal would act as just such a self-assessment device. The parties would set the ratio for splitting, and for tax purposes, setting the ratio as close to 50/50 would lower taxes the most. However, each spouse, particularly the economically stronger spouse, would know that the same ratio could be used if the marriage is terminated at the request of either party. Thus, as with the landowner wishing to lessen taxes through a low valuation of his property, the better-off spouse would have to consider not just the tax-lowering benefits of a ratio closer to 50/50, but also the possibility that he would lose property (including at least the fruits of human capital built up during the marriage) on divorce. The economically stronger spouse would like a relatively equal ratio for

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160. First, giving up power is a form of sharing. Second, giving up power may correlate positively with sharing of other power and consumption. Here, giving up power is a true proxy for further sharing. Measuring how well it functions as a proxy in this second sense would be quite difficult to investigate empirically. It is fortunate, then, that sharing of power seems to be a key form of sharing in its own right.

161. See Saul Levmore, *Self-Assessed Valuation Systems for Tort and Other Law*, 68 VA. L. REV. 771, 778-84 (1982) [hereinafter Levmore, *Self-Assessed Valuation Systems*] (describing simple self-assessment scheme for property taxation).

income-splitting but a less equal one for divorce, with divorce being the analog to the forced sale or governmental taking in the self-assessed property tax system. As in self-assessment generally, the economically stronger spouse faces countervailing incentives that are designed to elicit a valuation closer to the one he actually harbors.

The greatest objection to such self-assessment schemes in the taxation area is that they force those with idiosyncratic tastes into high valuations. For example, the homeowner who especially loves his bookshelves or garden will be forced into a high valuation to reduce the chance that a forcing buyer can turn him out. To protect a high idiosyncratic valuation, the homeowner will have to value the house for taxation purposes at what the next highest valuer would value it.<sup>162</sup> Such a self-assessment scheme thus has a tendency to tax consumer surplus, the value that the current owner assigns to the property over the market price. One can argue that consumer surplus *should* be part of taxable well-being, but the current tax law does not reflect this view and does not seem likely to do so soon.<sup>163</sup> Self-assessment schemes can be modified to avoid much taxation of consumer surplus, but the simplest schemes do pose the “problem” of taxing consumer surplus.<sup>164</sup>

The present scheme, however, does not face this problem of how to treat consumer surplus, because a couple, who chooses to opt into the system of splitting is negotiating the *ratio* of splitting, not an absolute value. More importantly, if the system consists of default separate filing, no one is forced to negotiate a ratio at all: The couple can only enjoy the benefits of splitting by backing it up with a corresponding sharing ratio for divorce. Unlike typical self-assessment schemes, negotiating the ratio does not force either spouse or the spouses jointly to expose themselves to full taxation on the basis of individual tastes.

Finally, we might want to set limits on the self-assessment scheme. These possible limits are of two types: floors and recapture rules. As a floor, we might want to prevent spouses from negotiating a ratio for income-splitting that is less generous than legal support obligations. For example, if a ratio of 95/5 would leave the less wealthy spouse worse off on divorce than current support obligations mandate, such a ratio should not be available. In this way, the prenegotiated ratio is no different from ante-

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162. *See id.*

163. *See supra* note 32 and accompanying text.

164. *See* Levmore, *Self-Assessed Valuation Systems*, *supra* note 161, at 783-88 (describing a “competitive” self-assessment scheme for property taxation partially as a response to the objection that self-assessment taxes consumer surplus).

nuptial agreements, which likewise cannot be used to contract around the mandatory rules of legal support.<sup>165</sup>

Through recapture rules, the second type of limit on the self-assessment scheme, intermediate filing can gain a great deal of flexibility. The simplest intermediate-filing system would require those couples who wish to opt into the system to do so once and for all. After negotiating a ratio to govern income-splitting for tax purposes, the couple would never be able to change it and would have to abide by it on divorce. This inflexibility may be undesirable because circumstances in the interim change. Most importantly, couples should not be prevented from moving the ratio closer to 50/50, and the empirical evidence is consistent with an increased commitment by many couples to sharing as time goes on.<sup>166</sup> On the other hand, allowing couples to change the ratio in either direction would defeat the purpose of intermediate filing. If couples could change the ratio, then the primary earner could work a tax-shelter-style deal about how to set the ratio. Even though this would be riskier than playing analogous games with legal title under current law, allowing free changes of ratio would probably make such deals too easy. One solution to the problem of changing circumstances would be to require all assets up to the point of the change (including human capital) to be governed under the original negotiated ratio and all subsequently acquired assets to be split under the new ratio. This would undoubtedly be extremely cumbersome and introduce much of the contentiousness about property division that intermediate filing shows promise of eliminating.

A somewhat better method of introducing flexibility into intermediate filing would be to couple it with a “recapture” rule. The Code uses recapture rules in some situations where after-the-fact it appears that deductions

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165. See, e.g., CAL. FAM. CODE § 1615(a) (West 1994) (providing for unenforceability of unconscionable premarital agreements); N.Y. GEN. OBLIG. LAW § 5-311 (McKinney 1989) (providing that generally “a husband and wife cannot contract to alter or dissolve the marriage or to relieve either of his or her liability to support the other in such a manner that he or she will become incapable of self-support and therefore is likely to become a public charge”); *In re Marriage of Higgason*, 516 P.2d 289 (Cal. 1973) (noting that an antenuptial agreement would not be valid if it sought to alter support obligations imposed by law), *overruled on other grounds by In re Marriage of Dawley*, 551 P.2d 323 (Cal. 1976). This prohibition is quite minimal since legal support obligations themselves are not very strong. See *infra* Part V.B.

166. See *supra* note 28 and accompanying text. The data from Philip Blumstein and Pepper Schwartz’s study show a correlation between length of relationship and verbal commitment to sharing, but this alone does not show causation running from the former to the latter. See BLUMSTEIN & SCHWARTZ, *supra* note 28, at 144-46. Thus, the data are consistent with either (i) more sharing couples staying together longer, or (ii) couples increasing their commitment to sharing as they stay together longer. Note too that the data is cross-sectional rather than time-series data.

allowed previously were too generous.<sup>167</sup> Under a recapture rule, some or all of the now inappropriate tax benefit is “recaptured” by subjecting the taxpayer to correspondingly higher tax after the inappropriateness emerges. One method would be to institute a scheme whereby if the couple decided to change the ratio, they would be subject to a recapture rule that would recoup from the wealthier spouse—the one with the larger leg of the negotiated ratio—the incremental tax advantage of past income-splitting plus interest. The “interest” could be defined to track any rate of return deemed appropriate.<sup>168</sup> Some penalty to cover administrative expenses could be added. Penalties could be punitive to any degree up to the point at which living with the prenegotiated ratio would be just as advantageous.<sup>169</sup> That is, the recapture rule could fall anywhere on the continuum from liability rule to property rule.<sup>170</sup> The recapture rule would allow changes in the ratio for changed circumstances but would protect the pressure not to overreport sharing and would prevent manipulation by the more economically powerful spouse. A cooling-off period could provide an additional deterrent from overreaching by such spouses: Any change in the ratio would not be honored on divorce for two years. On the other hand, if a recapture rule that recaptured all the benefit seemed too harsh and too difficult to apply, the recapture rule could be limited to recouping tax benefit from the last ten years only, possibly in conjunction with a penalty to cover administrative costs. Through such modifications, we could en-

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167. For example, the Code uses an array of recapture provisions to limit the conversion of ordinary income into capital gains through use of deductions (against current income) and capital gain treatment (at a lower rate) upon disposition. See I.R.C. § 467 (1994) (providing for taxation as ordinary income of portion of gain from previously leased property); *id.* § 1245(a)(3) (West Supp. 1998) (providing for recapture of previous depreciation deduction as ordinary income rather than capital gain); *id.* § 1245(a)(4) (providing for recapture of depreciation and loss deductions in connection with player contracts when a sports franchise is sold); *id.* § 1250 (providing for recapture of depreciation deductions in real estate context); *id.* § 1252 (1994) (providing for recapture of portion of soil and water conservation deductions on farmland held for less than 10 years); *id.* § 1254 (providing for recapture of currently deducted intangible drilling costs and mineral exploration and development costs); *id.* § 1255 (providing for recapture of amounts received as tax-free grants under § 126 where improved property is sold less than 20 years later). See also *infra* note 262 and accompanying text on the recapture rule known as the “tax-benefit rule.”

168. The “rate of return” may also have to be inflated if the marginal utility of money decreases over the lifecycle. As mentioned in the text, a recapture rule might aim at approximately the right level of deterrent. Alternatively, we have to face the complexities of treating a shift of ratio as a recognition event.

169. Alternatively, spouses could be allowed to change the ratio during the marriage but only in the direction of 50/50. This would allow for the ratio to reflect changes in circumstances but prevent overreaching by primary earners, especially those unilaterally contemplating divorce.

170. On the continuum of liability rules, see, e.g., Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis*, 109 HARV. L. REV. 713, 756-57 (1996).

sure that the incentives for high and low self-assessed ratios balanced each other out.<sup>171</sup>

### C. EQUITY

Considerations of equity support individual filing. Debate between proponents of joint and individual filing have engaged in what Edward McCaffery calls a “battle of the ‘neutralities.’”<sup>172</sup> Joint filing proponents complain that individual filing under a progressive rate schedule will lead to different couples with the same total household income paying different tax. According to this view, we must have joint filing in order to prevent the inequity of violating “couples neutrality.” Against this, those who favor individual filing cite the lack of neutrality between a member of a married couple and a corresponding single. Under joint filing, they complain, the same person will pay different tax depending on whether the person is married. As noted, this problem becomes especially acute for secondary earners, who in effect face a higher rate in marriage than as a single. The question then becomes which of these inequities—or equivalently which of couples or marriage neutrality—is more important.

Intermediate filing allows a way out of this dilemma. The proponents of joint filing believe in sharing, as do many of those in favor of individual filing. More importantly, the public seems to support sharing in marriages. Thus, a system like intermediate filing that is narrowly tailored to the amount of sharing may help us to decide which individuals and couples are similarly situated. As illustrated above with couples *C-C'* and *D-D'*, the extent to which marital sharing goes on is arguably the most important factor in whether two people are deemed to be similarly situated or not.<sup>173</sup> Asking whether two married couples with the same total income should pay the same tax is the wrong question. Similarly, whether marriage should affect someone's tax is the wrong question if asked without regard to whether one is sharing marital income as a transferor or recipient. The intermediate solution thus reduces the battle of the neutralities to our basic

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171. It might be asked why we do not just use individual filing with liberal property shifting possibilities and with a recapture rule on divorce if the split on divorce is less generous than the tax split during the marriage would indicate. First, this does nothing to address earned income and human capital. Second, such a system does nothing to ensure that people are aware of the tax consequences of their actions in shifting property. Because of this likely lack of awareness, individual filing with recapture only will offer few of the beneficial incentives of intermediate filing discussed later. For further discussion, see *infra* Part III.F.

172. McCaffery, *Fresh Look*, *supra* note 2, at 986. See also Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 358-63.

173. See *supra* notes 146-48 and accompanying text.

commitment to sharing. Value judgments are still unavoidable: The commitment to sharing itself is just such a value judgment. But given that sharing should matter most—and, as we have seen, this is a surprisingly uncontroversial view in the area of household taxation—intermediate filing serves such a commitment best.

Other questions that raise equity concerns are also handled well by intermediate filing. Couples with more earned income than property income and those with the reverse are equally well-off economically. Whether a dollar of income comes from services or property should not matter. If we tax them differently, we are failing to treat taxpayers who have a similar ability to pay in a similar manner—a violation of horizontal equity. As noted earlier, under individual filing, we are still faced with the problem of whom to tax on income from property. The two traditional solutions are to tax property income in proportion to the spouses' earned income or to tax property income to the owner of the underlying asset. The former may be unfairly generous to low-earning spouses with more property income and in any case may not reflect the long-term benefits from or present control over the property. If one spouse will get the property on divorce, and especially if the spouses think of the property as belonging to that spouse all along, there is little reason to tax the *other* spouse on the property income just because that other spouse might earn more from employment.

Because taxing in proportion to earned income presents equity problems of its own, most proponents of individual filing favor taxing property income to the owner.<sup>174</sup> But this leads to large opportunities for couples to avoid tax by shifting the indicia of ownership to allow property income to be taxed to the spouse facing the lower marginal rate. Due to the ability to move property around, a tax-shelter opportunity then arises.<sup>175</sup> More generally, if couples with property income are able to do this, they are unfairly advantaged when compared to couples with the same amount of income from employment.

In a further equity advantage of intermediate filing, allowing income-splitting only under the prenegotiated ratio gives wealthier spouses an incentive to be generous in setting up the ratio. It *promotes* sharing in the marriage, which will tend to benefit women on the whole. While it is an open question how *much* better off women would be under intermediate filing, if even some primary earners respond to the tax incentive to share,

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174. See, e.g., Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 384-91.

175. See *supra* note 152 and accompanying text.

some women will be better off. As discussed above, a recent study based on a “natural experiment” in the United Kingdom in which a child allowance was transferred from husbands to wives in the late 1970s supports the proposition that having the legal entitlement to income increases women’s share of consumption and control.<sup>176</sup>

Finally, unlike either joint or individual filing, intermediate filing treats the income of secondary earners from market labor and from domestic labor equally in terms of marginal tax rate. I return to this issue in the next section, but for now it is sufficient to note that those who choose market labor and those who opt for working in the home will both face the same tax on their “compensation.”<sup>177</sup> This is a major improvement over the present system and both the traditional polar systems (joint and individual), which allow compensation through marital sharing to escape tax altogether. This aspect, however, must be considered in the context of other likely consequences of a move to intermediate filing, which I will address below.

#### D. EFFICIENCY

Intermediate filing presents efficiency advantages. Economic analysis in this area is characterized by a series of partial equilibrium models. The most comprehensive of these is traditional “optimal tax” analysis. Under the traditional optimal-tax approach, welfare analysis of household taxation has been primarily a matter of identifying and measuring the deadweight loss associated with the secondary earner’s discouragement under joint filing from working in the marketplace. Other economists have pointed out that individual filing may cause distortions in the use of inputs in home production. In this section I will show that, in view of the trade-off between these two distortions—distortions of labor and home-production-factor decisions—intermediate filing probably fares better than both individual and joint filing under such a traditional analysis of overall deadweight loss. I will also show that the self-assessed ratio offers additional efficiency benefits that stem from its nature as a rule of marital contracting. These benefits include the reduction of strategic behavior

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176. See Lundberg et al., *supra* note 61, at 472-79. This natural experiment should go a long way towards allaying Ann Alstott’s concern that those supporting individual filing and child subsidies to secondary earners far too easily assume that this will increase women’s control over marital resources. See Alstott, *supra* note 28, at 2041-42. In addition to the Lundberg-Pollack-Wales study, earlier work supports the proposition that the more money women have, the greater their control (even if they do not control 100% of the extra money). See Kornhauser, *Partnership Model*, *supra* note 75, at 1427-28 nn.35-38, 1445 n.68 (citing studies).

177. See *supra* note 154 and accompanying text. See also *infra* Part III.D.1.

through the self-assessed ratio's function as a penalty default and the inducement of efficient precaution in marriage formation with the self-assessed ratio affording an expectation measure of damages upon divorce.

1. *Deadweight Loss from Labor- and Home-Production-Factor Decisions*

As discussed earlier, marital income sharing can be regarded as an exchange and/or a gift-giving, depending on the circumstances of the marriage.<sup>178</sup> Although these two aspects of marital sharing are intertwined in practice, for purposes of our initial efficiency analysis they may be treated separately before being considered together. I will show that with respect to both aspects of marital income-splitting, intermediate filing overall is likely to be more efficient than both joint and individual filing under a traditional optimal-taxation analysis. Turning first to the exchange aspect, I will demonstrate that intermediate filing should lead to a lower deadweight loss, considering both secondary-earner labor-supply and factor-input decisions in home production. I will conclude with some remarks on the efficiency advantages of intermediate filing with respect to marital income sharing as gift-giving.

Consider first marital income-splitting as an exchange of domestic labor for shared money income. The literature has devoted a great deal of attention to one distortion, that of the secondary earner's decision on whether and how much to work in the market. Commentators, however, have largely treated the use of time in the household as a black box under the misleading term "leisure." But this ignores the source of the high labor-supply elasticity of secondary earners: the high substitutability of home labor, rather than true leisure, for market work.<sup>179</sup> Moreover, by ignoring home production, such models overlook the distortion—from an efficiency point of view—of home production when the marginal rates on the spouses differ. I take up these two distortions in turn.

The treatment of spouses' labor supplies is the first distortion to be examined. Analysis of the deadweight loss from a tax usually begins with

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178. See *supra* Part II.B.4.

179. A few economists have focused on this aspect of the labor supply of women. See, e.g., Janet C. Hunt, Charles D. DeLorne & R. Carter Hill, *Taxation and the Wife's Use of Time*, 34 *INDUS. & LAB. REL. REV.* 426 (1981); Jane H. Leuthold, *Home Production and the Tax System*, 3 *J. ECON. PSYCH.* 145 (1983); Jane H. Leuthold, *Income Splitting and Women's Labor-Force Participation*, 38 *INDUS. & LAB. REL. REV.* 98, 98-105 (1984). McCaffery takes this point as support for individual over joint filing. See *MCCAFFERY, supra* note 2, at 181. While it is true that individual filing is less skewed against married women's market labor than is joint filing, even individual filing leaves economic well-being from domestic labor untaxed and thus excessively favors domestic over market labor.

the following basic insight from optimal-tax theory: A necessary condition for minimizing the deadweight loss from a tax is to tax items, such as commodities or labor supply, in inverse proportion to the responsiveness of the demand or supply of the item to a price change. This rule can be traced back to Frank Ramsey's pioneering work on commodity taxes in which he first proposed the optimal-tax rule.<sup>180</sup> According to optimal taxation, we should tax in inverse proportion to the elasticity (price sensitivity) of the demand for the commodity,<sup>181</sup> because where the demand for a commodity is very elastic, people will readily substitute away from it when the price increases. A tax increase can be regarded (more or less) as a price increase.<sup>182</sup> The substitution away from the commodity is a distortion in behavior relative to a no-tax world. The deadweight loss in welfare—the “excess burden” of the tax or the reduction in overall welfare from the tax—will be proportional to the size of this distortion. Thus, to minimize the deadweight loss, taxes should be imposed on commodities that are associated with low elasticities because the consequent distortions of behavior will be the smallest.

These insights have been carried over into the field of market labor supply.<sup>183</sup> Taxing income can be thought of as taxing labor supply. Although both income from property and earned income are taxed, the tax will be a function of how much someone works. It conceptually will increase the price of work. Under optimal-tax theory, those whose labor supply is most elastic will have the most distorted and welfare-decreasing response to a tax on wages (or the wage-tax part of an income tax). Therefore, in theory, workers should be taxed in inverse proportion to their elasticity of labor supply in order to minimize deadweight loss. In light of the fairly robust empirical results that married women's labor-supply elasticities are significantly higher than married men's,<sup>184</sup> optimal-tax theory sug-

180. See Frank P. Ramsey, *A Contribution to the Theory of Taxation*, 37 *ECON. J.* 47 (1927) (proposing the inverse-elasticities rule).

181. The elasticity of  $X$  with respect to  $Y$  is the ratio of a percentage change in  $X$  in response to a percentage change in  $Y$ , or  $(\delta X/\delta Y)(Y/X)$ , where the units of  $X$  and  $Y$  drop out. For example, the price-elasticity of demand of  $A$  is the ratio of the percentage change in demand in response to a percentage change in the price of  $A$  ( $P_A$ ). Or we can write  $(\delta A/\delta P_A)(P_A/A)$ .

182. Potential complications arise in a general equilibrium context, making it impossible to say that the price increase is equal to the tax. See *infra* notes 229-30 and accompanying text.

183. The literature is vast. See, e.g., Feldstein & Feenberg, *supra* note 4, at 40-41. See also MCCAFFERY, *supra* note 2, at 168-84.

184. See *supra* notes 92-97 and accompanying text. As we will see, the wide range and remaining uncertainty in studies of labor-supply elasticities are troublesome to those who count on an increase in female labor supply due to a lowering of tax. See, e.g., Mroz, *supra* note 94, at 795-96 (noting the wide range of estimates).

gests that men should be taxed more than women.<sup>185</sup> Whether this would be regarded as fair or not is another question, but as long as we focus on the labor-supply decision, optimal-tax theory suggests that efficiency requires lower taxes on married women than on married men. Because women still typically earn less than men, individual filing would go some way to effecting this result. For this reason, optimal-tax theory provides some support for individual filing in the joint-versus-individual-filing debate.

This support, however, is far from complete. First, notice that although optimal tax suggests lower taxes for married women, this does not mean that individual filing provides exactly the correct level of differential between taxes on secondary earners and taxes on primary earners (or between women and men). Indeed, optimal-tax theory probably would require an even greater differential between women's and men's tax rates than provided for by individual filing.<sup>186</sup> The elasticity studies do vary considerably, but as we will see, the case for intermediate filing does not depend on labor supply effects being large or small.<sup>187</sup> If our choices are limited to individual filing or joint filing, the general consensus holds that optimal-tax theory provides support for individual over joint filing.

Labor-supply decisions are not the only ones distorted by taxes. The familiar optimal-tax result does not take account of home production, which presents room for a different type of distortion. John Piggott and John Whalley have recently argued that efficiency considerations do not unambiguously point in the direction of individual filing. Rather, the effects of the inverse-elasticity rule must be balanced against factor-input distortions.<sup>188</sup> The lower taxes on the secondary earner's wages can make the secondary earner's market labor more attractive relative to the primary earner's than it would be in a no-tax world. Piggott and Whalley claim that individual filing may cause a large enough distortion in factor-input decisions that the efficiency gained by reducing these distortions with joint filing may in some cases outweigh the efficiency gained from lowering

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185. See, e.g., Feldstein & Feenberg, *supra* note 4, at 40-41; KILLINGSWORTH, *supra* note 92, at 348-52; MCCAFFERY, *supra* note 2, at 168-84. Consistently with this result, other studies have demonstrated that women's perceptions of the marginal tax rate they face are fairly accurate, but men's are not. See Harvey S. Rosen, *Taxes in a Labor Supply Model with Joint Wage-Hours Determination*, 44 *ECONOMETRICA* 485, 487-503 (1976). See also KILLINGSWORTH, *supra* note 92, at 356-58 (discussing the Rosen study).

186. See *infra* note 234 and accompanying text.

187. See *infra* Part III.D.4.

188. See John Piggott & John Whalley, *The Tax Unit and Household Production*, 104 *J. POL. ECON.* 398, 411-17 (1996).

relative taxes on secondary earners. Thus, when the factor-input effect dominates,<sup>189</sup> efficiency is in tension with a policy of promoting women's labor participation.<sup>190</sup> Piggott and Whalley also present Australian data that they claim to be consistent with the model's predictions.<sup>191</sup>

In a recent working paper, Patricia Apps and Ray Rees point out that Piggott and Whalley's result only holds under rather extreme assumptions about how low marginal rates on married women would be under individual filing.<sup>192</sup> More importantly, Apps and Rees argue that joint filing is unlikely to be superior to all levels of "separate taxation."<sup>193</sup> Apps and Rees define "separate taxation" as any system that provides for different marginal rates for spouses. Separate taxation *under some rate or other* will be a better second-best solution than joint taxation. Thus, from a starting point of joint taxation, small movements away from equal marginal rates on the spouses will be welfare-improving overall—as long as we focus on the two distortions in question. The problem is one of a *trade-off* between two distortions: Movements toward much lower rates for secondary earners will reduce the labor-supply distortion but will increase the home-production distortion; conversely, a move towards more equal rates will reduce the home-production distortion but at the expense of increasing the labor-supply distortion. In a nonideal world, efficiency is generally better served by reducing some of each distortion in such a trade-off rather than by eliminating either distortion completely. Thus, Piggott and Whalley's advocacy of joint taxation is misplaced, but their exposition of the trade-off is well taken.

Joint filing therefore is likely to be inferior to both a realistic individual filing system<sup>194</sup> and the system of intermediate filing proposed in this Article. Notice first that intermediate filing would count as a form of "separate taxation" in the model Apps and Rees present. Unless every single couple bargained into a 50/50 ratio, intermediate filing will tax some spouses at different rates. The optimal point in light of the trade-off be-

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189. See PATRICIA F. APPS & RAY REES, *INDIVIDUAL VS. JOINT TAXATION IN MODELS WITH HOUSEHOLD PRODUCTION* (Australian National University Working Papers in Economics and Econometrics No. 330, 1997).

190. On the disagreement among feminists about this policy and the occasional tension between efficiency analysis and some feminists' concerns, see *infra* Part III.D.4.

191. See Piggott & Whalley, *supra* note 188, at 403-11.

192. See APPS & REES, *supra* note 189, at 3, 9.

193. See *id.* at 7-10.

194. By "realistic individual filing system," I mean individual filing with rates dependent solely on income, rather than on secondary-earner status or wealth. Accordingly, a "realistic" system would not have negative rates for secondary earners in general but might have negative rates for low earners, as under a program like the Earned Income Tax Credit.

tween the two distortions in labor-supply and factor-input decisions lies somewhere between very different rates for spouses—perhaps with negative rates on the secondary earner—and joint taxation. Individual filing based on rates determined by income level<sup>195</sup> and intermediate filing will lie in this middle ground. One or both of them likely will be closer to the optimal point than either extreme of separate taxation or joint taxation. However, the rate of trade-off between the two distortions—how much increase of the labor distortion we get for a reduction in the home-production distortion—is unknown. Also, at what point the marginal changes in these two distortions equal each other, reaching the optimal point, is unknown as well.

In light of this trade-off, intermediate filing may present advantages beyond those of even realistic individual filing. Couples who would face the factor-input distortion could opt into the intermediate-filing system and choose a relatively equal ratio. As with all default rules, we must ask whether parties for whom the default is inefficient will contract into an efficient arrangement. Two factors point toward optimism in the case of intermediate filing with default individual filing. First, those couples for whom the factor-input distortion looms largest also have the most incentive to negotiate a relatively sharing ratio.<sup>196</sup> The gains from moving closer to joint filing are fully internalized to the married individuals, who will split the gains from the bargain. Further, even despite the transaction costs incurred in negotiating a nondefault ratio, the stakes may be quite high—spread out over the life of the marriage and beyond—compared to a one-time cost of negotiating. Thus, more than in the case of most contractual defaults, intermediate filing provides some assurance that a penalty default can work.<sup>197</sup> In any event, the nonmandatory nature of the individual-filing default of intermediate filing should go a long way towards mitigating the distortionary effects in factor-input decisions. In contrast, under individual filing, those who face large home-production distortions are burdened with the same rate differential between the spouses as is eve-

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195. Consider this as opposed to individual filing based on rates determined by sex or status as a primary or secondary earner as might be required for separate taxation aimed at eliminating labor-supply distortions.

196. See GROSSBARD-SHECHTMAN, *supra* note 127, at 25-83 (1993) (extending Becker's theory of marriage into unified theory of labor and marriage markets); Alan Freidan, *The U.S. Marriage Market*, in *ECONOMICS OF THE FAMILY*, *supra* note 102, at 352, 365-66 (presenting empirical evidence that potential gain from marriage and proportion of women married is positively related to sex-specific relative wage). Cf. BECKER, *supra* note 35, at 330 (noting the correlation between investment in human capital and delay in marriage); Becker, *A Theory of Marriage*, *supra* note 102, 301-08 (noting that an increase in wage rate of women relative to men would decrease incentive to marry).

197. On the functioning of intermediate filing as a penalty default, see *infra* Part III.D.2.

ryone else. Unlike individual filing, intermediate filing shows promise of providing some targeted relief to the home-production distortion that is not possible on any system that uses income alone as the determinant of marginal rates.

Finally, precisely because individual filing enforces sharing, it may present special advantages in the area of women's labor supply. A recent study compared women's labor supply before and after a move to unilateral divorce in states with community property and those with equitable distribution laws.<sup>198</sup> Where the shift led to increased bargaining power for the wife—that is, in community-property as opposed to equitable-distribution jurisdictions<sup>199</sup>—wives worked more and spent less time in home production, leaving leisure time far less affected.<sup>200</sup> Where the change to unilateral divorce decreased married women's bargaining power, such as in equitable-distribution states, they decreased their labor supply.<sup>201</sup> Interestingly, the same study found no significant increase in divorce following adoption of unilateral-divorce laws, leading to the hypothesis that marital transfers in the form of work-pattern shifts occur to prevent divorce.<sup>202</sup> If intermediate filing strengthens women's bargaining position, as I have argued, then this hypothesis, if true, may lead to an expected increase in labor supply of women under an intermediate filing system. Although much study remains to be done, these findings provide further indication that intermediate filing may be superior to any filing system that is not coupled with a change in marital property law.

Now consider marital income sharing as gift-giving. To the extent that marital income is given to another spouse with no strings attached, intermediate filing also leads to efficiency advantages. The U.S. income tax gives no deduction for donors and does not tax gifts to recipients.<sup>203</sup> This treatment may reflect an uneasy compromise between our views about the fairness of taxing those who consume or control and administrative convenience. From a pure efficiency standpoint, however, a strong

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198. See Jefferey S. Gray, *Divorce-Law Changes, Household Bargaining, and Married Women's Labor Supply*, 88 AM. ECON. REV. 628 (1998).

199. This is not to say that community property protects women as much as it could or should. See *infra* Part V.A.

200. See *id.* at 632-39.

201. See *id.*

202. See *id.* at 632-34. But see Leora Friedberg, *Did Unilateral Divorce Raise Divorce Rates? Evidence from Panel Data*, 88 AM. ECON. REV. 608 (1998) (finding some increase in divorce rates attributable to adoption of unilateral divorce).

203. See *supra* note 114 and accompanying text.

argument can be made for lower taxes on nonexchange gifts.<sup>204</sup> This is because the more altruistic the giving, the more giving will increase the utility of both donor and recipient. As a result, because the amount of income given enters the social welfare function or overall utility twice, subsidizing gift-giving will increase overall welfare. Because intermediate filing allows couples to lower their taxes through a self-assessed ratio if marital income giving is taking place, the system would encourage welfare-increasing behavior. Individual filing does not allow for this because earned income is always taxed to the earner and property income is shiftable with little guarantee that a genuine gift has been made. Conversely, joint filing may both overstate gift-giving by allowing income-splitting regardless of whether sharing is really occurring and fail to treat those who share better than those who do not. Importantly, *at the margin* there is no incentive in terms of lower taxes for interspousal gift-giving under joint filing. For the primary earner and the couple as a whole, taxes are at the same lower marital rate under joint filing regardless of whether additional sharing takes place. Thus, from an efficiency standpoint, the more marital income sharing is like a gift and the more altruistic the giver, the better intermediate filing works.<sup>205</sup>

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204. See Louis Kaplow, *Tax Policy and Gifts*, 88 AM. ECON. REV. 283, 284-87 (1998). For a parallel argument about the welfare-increasing effects of bequests, see Joseph E. Stiglitz, *Pareto Efficient and Optimal Taxation and the New Welfare Economics*, in 2 HANDBOOK OF PUBLIC ECONOMICS 991 (Alan J. Auerbach & Martin Feldstein eds., 1987).

205. We might ask what the consequences are of the increase in the secondary earner's marginal rate from the receipt of the gift of some of the primary earner's income. Under progressive rates, the gift will have the potential to raise the secondary earner into a higher bracket—a version of the stacking effect on a smaller scale. The implications for efficiency analysis and for those seeking to promote women's market labor, such as McCaffery, may diverge here. From a welfare standpoint, the relevant effects are the increase in both spouses' welfare from the gift and the effect on both their labor supplies. To the extent that gifts are taxed to someone, that someone will face higher marginal rates on all income, including that from labor. First, notice that under intermediate filing, taxing the gift to the recipient secondary earner will *not* distort the market-versus-domestic-labor decision because earnings from *both* are in effect taxed under the self-assessed ratio of intermediate filing. As discussed earlier, the big substitution effect for women is between market and domestic labor, not between both or either type of labor and leisure. As for the distortionary effect on leisure of taxing gifts, there is little reason to suppose that taxing them to the recipient secondary earner is worse than taxing them to the transferor. In addition to the double-utility effect noted in the text, any distortion of the secondary earner's labor-leisure decision from higher taxes must be offset against a decrease in such distortion of the primary earner's labor-leisure decision. Since the primary earner is at a higher marginal rate and since there is little reason to suppose women's substitution effect on leisure is greater than men's in the presence of taxation of all labor, the marginal benefit from lowering the primary earner's leisure decision distortion is likely to be greater than the marginal increase in distortion of the secondary earners' corresponding decision. Thus, even when cross-effects are considered, the taxation pattern under intermediate filing is unambiguously welfare-improving.

As illustrated in this discussion of the efficiency consequences of intermediate filing, regardless of whether marital income sharing is treated as an exchange or gift-giving, the attractiveness of intermediate filing is clear. Intermediate filing is likely to represent a more efficient trade-off between labor supply and home-production distortions than do the polar choices of joint and individual filing.

## 2. *Eliminating Strategic Contractual Inefficiencies*

Traditional deadweight loss analysis of the household taxation problem relies on the underlying assumption that the marriage already exists. Because the marriage decision itself—as opposed to time-allocation decisions within the marriage—may or may not be sensitive to taxes, this traditional mode of analysis is not implausible. However, intermediate filing carries with it efficiency benefits from its ability to improve the *process* of marriage contracting. Intermediate filing can operate as an information-forcing “penalty default” in marriage formation.<sup>206</sup>

Contractual defaults are either mandatory or default rules. Contractual parties are not allowed to contract around a mandatory rule, but they may elect to contract around a default rule. “Immutable” or “mandatory” rules reflect paternalism or an effort to prevent negative externalities.<sup>207</sup> Examples of immutable rules include the Uniform Commercial Code’s duty to act in good faith, minimum wage laws in employment, implied covenants of habitability in landlord-tenant law, and support obligations on divorce. Default rules can be classified as “majoritarian” or “penalty” defaults. A majoritarian default rule is designed to mimic what most contracting parties would contract for if they thoughtfully considered the matter.<sup>208</sup> The goal is to minimize the transaction costs involved in negotiating the particular provision in question for as many parties as pos-

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206. On penalty default rules in contract law, see Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 95-107 (1989) [hereinafter Ayres & Gertner, *Filling Gaps*]. The literature on default rules in contracts is quite large. See, e.g., Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729 (1992); Lucian A. Bebchuk & Steven Shavell, *Information and the Scope of Liability for Breach of Contract: The Rule of Hadley v. Baxendale*, 7 J.L. ECON. & ORG. 284 (1991); Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489 (1989); Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 YALE L.J. 615 (1990). See also *Symposium on Default Rules and Contractual Consent*, 3 S. CAL. INTERDISC. L.J. 1 (1993).

207. See Ayres & Gertner, *Filling Gaps*, *supra* note 206, at 87-88.

208. See Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967-971 (1983); Ayres & Gertner, *Filling Gaps*, *supra* note 206, at 92.

sible. A penalty default, on the other hand, represents what a party with information would *not* want and is designed to force that party to reveal the information in the process of contracting around the penalty default.<sup>209</sup> Thus, for example, Ian Ayres and Robert Gertner analyze the rule of *Hadley v. Baxendale*<sup>210</sup> against awarding consequential damages unless the other party knows or has reason to know of the probable damage as a penalty default. The party with the information about potential harm must either contract around the *Hadley* rule, thereby revealing information that is useful to contract formation, or not receive damages for that harm.<sup>211</sup>

Intermediate filing is designed to have the same beneficial information-forcing effect. If the economically advantaged spouse wants to seize the carrot of income-splitting, she must disclose an important aspect of how equal she wants the marriage partnership to be. Intermediate filing thus works as a penalty default, forcing the economically-advantaged spouse to share vital information with the other spouse. This means that less wealthy spouses will have better information about their rights and about their partners' intentions. As a result, inefficiency in marriage formation from strategic behavior can be reduced.<sup>212</sup> Thus, the information-forcing effect of the self-assessment approach may lead to more efficient marriage formation.

The strong likelihood that this information-forcing effect will be particularly important emerges from Kornhauser's data on deception and self-deception.<sup>213</sup> People may say they favor more splitting than they are actually willing to do. If so, intermediate filing has the advantage of forcing this information onto the table. Interestingly, the information-forcing effect may arise whether or not the parties contract around default individual filing and into a different ratio. If the parties contract into a ratio, the ratio provides the economically more precarious spouse vital information she might not otherwise have about where she stands; there will be less chance that she will detrimentally rely on empty rhetoric about partnership from her "partner." If, on the other hand, there is a large imbalance in the resources of the spouses, then opting into a more equal ratio would save

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209. See Ayres & Gertner, *Filling Gaps*, *supra* note 206, at 95-100.

210. 9 Ex. 341, 156 Eng. Rep. 145 (1854).

211. See Ayres & Gertner, *Filling Gaps*, *supra* note 206, at 101-04.

212. Becker has analyzed how divorce is a response to imperfect information in the marriage market. See BECKER, *supra* note 35, at 324-41.

213. See Kornhauser, *Partnership Model*, *supra* note 75, at 1427 nn.31-32 ("[P]eople lie to themselves [about sharing]: they lie to others . . . People may say they share but act inconsistently with that statement; they may even make inconsistent statements."); Kornhauser, *Love, Money, and the IRS*, *supra* note 2, at 80-84 (setting forth data indicating deceptive answers about sharing).

taxes. If the economically stronger spouse nevertheless does *not* want to contract a more equal ratio, then this too reveals a lack of willingness to engage in meaningful sharing. Thus, unlike most penalty defaults, intermediate filing, incorporating default individual filing, is likely to have an information-forcing effect in all the contexts in which it is most important.

The information-forcing benefits are closely tied to the overall value of antenuptial agreements. Traditionally, the law has been suspicious of antenuptial agreements as likely to promote divorce.<sup>214</sup> More recently, commentators have argued that the value of antenuptial agreements in terms of optimal sorting (who gets married),<sup>215</sup> reducing incentives to engage in opportunistic behavior,<sup>216</sup> lowering the costs (including third-party effects) of messy divorces,<sup>217</sup> and protecting the spouse who invests more in the marriage<sup>218</sup> outweigh the disadvantages of increased attention to the possibilities of divorce. Likewise, these benefits and respect for individual choice are increasingly seen as outweighing a paternalistic concern for people's tendency to make mistakes.<sup>219</sup> Even with respect to the traditional concern over the divorce rate, it is probable that giving the economically weaker spouse—the one who has more marriage-specific investments—more rights on divorce would lower the divorce rate. The wife's increased incentive to divorce is likely outweighed by the decrease in the husband's incentive to seek divorce.<sup>220</sup> Under a no-fault regime, which is the norm today, making the spouses' reservation utilities more equal by

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214. See, e.g., *In re Marriage of Noghrey*, 215 Cal. Rptr. 153 (Ct. App. 1985) (denying enforcement of a wife's contractual claim to \$500,000 on the grounds that the prospect of such a claim gave the wife an incentive to seek divorce).

215. See, e.g., Jeffrey Evans Stake, *Mandatory Planning for Divorce*, 45 VAND. L.J. 397, 428 (1992) (citing use of better information about prospective spouses in the decision whether to marry that person as support for a system of mandatory antenuptial agreements). See also BECKER, *supra* note 35, at 324-41 (discussing divorce as result of the imperfect information in the marriage market).

216. See, e.g., Margaret F. Brinig & Steven M. Crafton, *Marriage and Opportunism*, 23 J. LEGAL STUD. 869 (1994).

217. See, e.g., Stake, *supra* note 215, at 428 (noting external costs of divorce that can be lowered through antenuptial agreements and suggesting that less-than-full internalization of such benefits is one reason that antenuptial agreements are not more widespread).

218. See, e.g., Brinig & Crafton, *supra* note 216, at 875-76, 887, 893; Stake, *supra* note 215, at 416.

219. See Robert H. Mnookin, *Divorce Bargaining: The Limits on Private Ordering*, 18 U. MICH. J.L. REFORM 1015, 1031 (1985); Marjorie Maguire Shultz, *Contractual Ordering of Marriage: A New Model for State Policy*, 70 CAL. L. REV. 207, 241-42 (1982).

220. See, e.g., Lloyd Cohen, *Marriage, Divorce, and Quasi Rents; Or, "I Gave Him the Best Years of My Life,"* 16 J. LEGAL STUD. 267, 293 (1987) ("It is this more rapid using up of the woman's capital asset that creates incentives for the husband to terminate the marriage and causes difficulty for women in replacing their husbands following divorce.").

evenly distributing the benefits and burdens of divorce may well lead to fewer divorces.<sup>221</sup>

Indeed, many of the problems blamed on antenuptial agreements—based on the arguments that divorce becomes too easy, that a focus on divorce undermines the marriage, and that people cannot choose well for themselves—are also largely a function of general divorce law itself. For example, the most obvious reason for divorce being too easy is no-fault divorce, and proposals to introduce fault into property division would most directly address that problem.<sup>222</sup> The couple's negotiated ratio could serve as a presumption: If the primary earner were abusive or the secondary earner shirked, some remedy could be provided for in the antenuptial agreement, or, if sufficient unfairness resulted, by a judge on divorce. In any case, I will assume in the following discussion that any disadvantages of the option of antenuptial agreements and the self-assessed ratio are outweighed by the advantages. In particular, the benefits of information-forcing in this context from better sorting and reduced incentives for opportunistic behavior likely outweigh the costs, if any, of the greater information.

### 3. *Expectation Damages*

The information-forcing effect of intermediate filing is not its only contract-like advantage. Opting into the self-assessed ratio of intermediate filing also works like expectation damages and, in particular, like an opportunity to set up liquidation damages. Although current law sometimes looks unfavorably on liquidated damages provisions, intermediate filing partakes of the benefits of liquidated damages and not the drawbacks.

From an efficiency standpoint, the presumption should favor liquidated damages provisions.<sup>223</sup> Often the parties will be in a better position to estimate damages than a court will be able to measure them *ex post*. One party may be trying to signal extra commitment to the deal or may be trying to protect against special harm he would suffer on breach. If so, liquidated damages can be expected to induce efficient precaution in the parties. Liquidated damages provisions are suspect, however, when either

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221. Also, as Robert Scott argues in the commercial context, transferring risk to the party best able to control the production process or who places a lower subjective cost on the risk, or distributing the risk will lower the likelihood of opportunism. See Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CAL. L. REV. 2005, 2021 (1987). See also Brinig & Crafton, *supra* note 216, at 873-75 (recognizing Scott's analysis to marital contract).

222. See, e.g., Brinig & Crafton, *supra* note 216, at 892-94.

223. For a summary of the arguments for and against liquidated damages and references to the literature, see THOMAS J. MICELI, *ECONOMICS OF THE LAW* 83-87 (1997).

there is some procedural defect in their formation or they impose externalities. The former do not distinguish liquidated damages provisions from other contractual provisions. However, under externalities, Tai-Yeong Chung has argued that in sales where there is uncertainty over what another buyer might offer for the goods, a high liquidated damages provision might inefficiently reduce the probability of efficient breach.<sup>224</sup>

The intermediate-filing option is worth considering in light of this discussion of liquidated damages. Couples opting into the intermediate system by negotiating a ratio to govern income-splitting and property division on divorce are in effect setting up a liquidated damages provision for divorce. This ratio should exhibit the benefits of liquidated damages in two respects. First, although the parties may or may not be aware of the probability that they might divorce, the bargain they strike before marriage is likely to be a better and less-expensive measure of sharing than the decision of a divorce judge listening to the self-serving evidence of antagonistic parties.<sup>225</sup> Second, one spouse may signal in negotiations of the ratio the extra commitment necessary to maximize the gains from the marriage, or for the marriage to happen at all.<sup>226</sup>

Nor does intermediate filing suffer from the disadvantages of liquidated damages provisions. In this respect, the externalities argument cuts the other way: In marriage, we generally do not want to promote efficient breach. We are not worried that a divorce settlement will interfere with the chances for a homebreaker and one of the spouses getting together. We can cast this argument in moral or economic terms. From the perspective of society's shared values, marriage should not be indissoluble, but

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224. See Tai-Yeong Chung, *On the Social Optimality of Liquidated Damage Clauses: An Economic Analysis*, 8 J.L. ECON. & ORG. 280 (1992).

225. See, e.g., Stake, *supra* note 215, at 416-20.

226. The benefits and costs here are somewhat similar to those that arise from giving couples a choice of divorce regimes at the time they marry. However, because intermediate filing does not provide for the complete elimination of either spouse's exit option, both benefits and especially the costs are probably lower. See, e.g., Eric Rasmusen & Jeffrey Evans Stake, *Lifting the Veil of Ignorance: Personalizing the Marriage Contract*, 73 IND. L.J. 453 (1998) (proposing to allow couples to contract for a wide range of divorce regimes). But see Kathryn Abrams, *Choice, Dependence, and the Reinvigoration of the Traditional Family*, 73 IND. L.J. 517 (1998) (arguing that choice in marital contracting provides inadequate protection and false security to those specializing in home production); Gregory S. Alexander, *The New Marriage Contract and the Limits of Private Ordering*, 73 IND. L.J. 503, 505-10 (1998) (objecting to the Rasmusen-Stake scheme based, inter alia, on information costs, cognitive errors, and public ordering concerns, but acknowledging that allowing contracting over property division presents these problems to a far lesser degree). The gains from being able to choose a ratio must also be offset against the losses from being shown not to have this level of commitment, which returns us to the information-forcing issues of the previous section. Similar information-forcing issues are raised by proposals for "covenant marriage" and the Rasmusen-Stake proposal.

dissolution is not as desirable as would be the selling of a house to a higher bidder. From an economic perspective, the externality of weakening the marriage institution is far more serious with effects on many more third parties (especially children) than the arguable weakening effect of efficient breaches on the institution of promising and third-party implications.<sup>227</sup>

Thus, as a measure of damages, the self-assessed ratio, possibly limited by a recapture rule, will function like a system of liquidated damages.<sup>228</sup> Intermediate filing is likely to exhibit the beneficial aspects of liquidated damages. Externality arguments used against liquidated damages actually favor individual filing as well.

#### 4. *Efficiency Analysis in Perspective*

I have argued that, in considering various partial equilibrium economic models, intermediate filing likely does better from a welfare perspective than joint or individual filing. Intermediate filing may lead to the smallest deadweight loss from labor and factor-input distortions, will force information from the parties that is relevant to efficient marriage formation, and will act as a system of efficiency-enhancing liquidated damages.

Although these advantages are substantial, there are good reasons not to base too much of our overall evaluation of intermediate filing on efficiency considerations. First, research in the area of labor supply and taxation is still based on partial equilibrium models. A general equilibrium model taking into account the effect of changes in labor supply on gross wage rates and feedback effects on labor supply is still in the future.<sup>229</sup> From today's partial equilibrium models, we cannot draw firm conclusions about the overall efficiency effects of a change in tax law.<sup>230</sup> The hypotheses possible under partial equilibrium models, however, do support the desirability of intermediate filing.

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227. For a moral or property-rights-based argument against the notion of efficient breach, see generally Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1 (1989) (likening to theft the deliberate breach of a contract in favor of a better offer).

228. The recapture rule may have the effect of limiting the liquidated damages. How limiting it should be will depend on the balance between the need for flexibility and the deviation from optimal damages. Note, however, that as compared to present law, the liquidated damages in divorce are likely to be less. Therefore, if the recapture rule approach results in damages that are smaller than the optimal level, current law is likely to be even more deficient in this regard. On the family law implications of intermediate filing, see *infra* Part III.E.

229. For a discussion of the difficulties involved, see KILLINGSWORTH, *supra* note 92, at 340.

230. Cf. Alstott, *supra* note 28, at 2009-33 (noting that rough economic knowledge of compensated elasticities provides only weak support at best for individual filing).

The information costs of implementing a proposal cannot be left out of the efficiency analysis. Ignoring the information costs, the efficient solution would be to inquire at the individual level about labor-supply elasticity and home-production-factor distortions, and to pick the individual tax rate that minimizes the sum of the two distortions. Needless to say, the information costs would be prohibitive. This is especially important in light of the range of elasticity estimates in the literature.<sup>231</sup> Some have even questioned whether the effect of marginal rates on women's labor supply is all that great,<sup>232</sup> but nothing in the present proposal depends on its being large or small. Narrowly tailored to the problem of sharing, intermediate filing may require less knowledge about the exact effects of tax levels on labor supply than does individual filing.<sup>233</sup> Intermediate filing shows promise of harnessing some private information and reducing the informational burden on lawmakers. This advantage has long-term importance across time: Making secondary earners', or, alternatively women's tax rates depend on elasticity (and other) studies means that new measurements must be taken and rates must change if underlying supply schedules change over time. Nor does intermediate filing call for negative rates on secondary earners or women, something that would be politically impossible.<sup>234</sup>

The intermediate filing system subjects the secondary earner to the same marginal rate on domestic and market labor. If the secondary earner, such as *C'* in the scenario above, will make the decision of whether and how much to work outside the home based in part on whether her domestic labor is "compensated" by shared income from the primary earner, then intermediate filing, unlike joint or even individual filing, taxes both sources of income the secondary earner is weighing. That is, if *C'* works in the home and in exchange receives income from the primary earner, that income is taxed to *C'* just as earnings from a job outside the home would

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231. See KILLINGSWORTH, *supra* note 92.

232. See Alstott, *supra* note 28, at 2017-22.

233. This is subject to the usual provisos relating to what the rest of the tax system does, particularly with respect to taxation of commodities that are complements of the activities that the analysis concerns. For a general discussion, see Stiglitz, *supra* note 204, at 1023-27.

234. For example, McCaffery has argued from an optimal-tax perspective that "[a] strong theoretical case exists for altering the basic rate structure to provide significantly lower, even negative, rates for secondary earners, financed by higher rates on primary earners." McCaffery, *Fresh Look*, *supra* note 2, at 1060. McCaffery has grown to recognize the political difficulties involved and advocates no rate differential beyond that implied by the separate filing system he now supports. See MCCAFFERY, *supra* note 2, at 278-80. See also Zelenak, *Tax and the Married Woman*, *supra* note 67, at 1047 (noting this evolution in McCaffery's approach).

be. Under intermediate filing, domestic and market labor are subject to the same marginal rates.

This equality of marginal rates may be particularly important because the secondary earner is most sensitive to marginal tax rates. Furthermore, domestic labor would for the first time enter into the Social Security Tax system, which has been argued for on feminist grounds.<sup>235</sup> This Social Security tax on domestic labor is attainable without the politically unacceptable and inevitably too coarse-grained imputation of values to taxpayers.<sup>236</sup> On the other hand, the lower taxes on a primary earner in a couple opting into an even ratio may lead to a shift outward in demand for spousal labor. Whether or not this constitutes a distortion in efficiency terms depends on the baseline for comparison. As I argued above, intermediate filing will likely provide some targeted reduction in home-production distortions.<sup>237</sup>

The question remains, however, what the overall effect on the labor supply of women bargaining into a relatively even ratio will be. On the one hand, demand for domestic labor may increase as may the quasi-wage that some secondary earners can earn, as well as those secondary earners' reservation wage—the wage below which they will choose not to work. Both of these factors may push married women's market labor down, but also increase women's welfare. On the other hand, the taxation of marital "compensation" may reduce some tax-favored status of domestic labor under the other systems. Moreover, the increased bargaining power of married women resulting from a move to individual filing might increase married women's labor supply. As noted earlier, there is at least indirect empirical support for this proposition.<sup>238</sup>

Thus, interestingly, the present proposal can help isolate where sharing fits into an overall concern with women's welfare. For those who believe that breaking down the gendered division of labor is the most important goal,<sup>239</sup> the fact that women have more "choice," with a higher quasi-wage for domestic labor, will not be decisive.<sup>240</sup> On such a view, sharing should be regarded as a mixed blessing because it may raise married women's reservation wages and leads them to work less in the market.

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235. See Staudt, *supra* note 53, at 1642-43.

236. See, e.g., Richard Posner, *Conservative Feminism*, 1989 U. CHI. LEGAL F. 191, 193; Staudt, *supra* note 53, at 1571-75, 1620-27.

237. See *infra* Part III.D.1.

238. See *supra* text accompanying notes 198-202.

239. See, e.g., MCCAFFERY, *supra* note 2, at 184; Kornhauser, *Love, Money, and the IRS*, *supra* note 2, at 105-11; Note, *supra* note 23, at 382.

240. See MCCAFFERY, *supra* note 2, at 287 n.183.

Other feminists, however, have stressed the importance of choice for women and have not regarded domestic labor as inherently problematic.<sup>241</sup> For them, sharing is mostly positive: It directly increases women's welfare and increases their choice. Thus, the general acceptance of sharing<sup>242</sup> is put to the test through individual filing: One's attitude to sharing itself should depend on one's view of women's long-term interests.

This discussion of efficiency is meant mainly to answer the supposed efficiency benefits touted by proponents of the polar systems. None of this should obscure the main point of this Article, however, which is that if we pay attention to the role of sharing, progressive rates do not inevitably lead to unacceptable normative choices and can bring out the relationship of sharing to other normative commitments. Adopting a system based on self-assessed ratios supports the ideal of a sharing marriage and makes women better off in many respects. Either filing separately by default or opting into increased security of marital property rights would benefit the secondary earner. Removing the current marriage penalty would benefit two-earner couples, among whom the marriage penalty is quite common, and would help low-income couples for whom the penalty is disruptive of family formation in the first place.<sup>243</sup>

#### E. IMPLICATIONS FOR FAMILY LAW

Intermediate filing ties tax treatment to the rule of property division on divorce for those who opt into the system. As this section will demonstrate, this voluntary, integrated approach to marital property has several advantages outside the boundaries of tax policy. Most importantly, it offers a partial answer to the vexed question on divorce of whether and how to divide human capital developed during the marriage. The voluntary nature of the system at the individual level and, if so desired, the state level, provides an answer to objections from federalism that family law is traditionally a matter for state law. The voluntary nature of intermediate filing and its ability to define property rights for those who choose a ratio also point to a solution to the problems of joint and several liability after divorce for tax arising during the marriage. Finally, many of the equity and efficiency advantages of intermediate filing in taxation carry over into family law as well.

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241. See, e.g., Alstott, *supra* note 28, at 2035; Staudt, *supra* note 53, at 1614-18.

242. See *supra* Part II.

243. On the incidence of the marriage penalty, see CONGRESSIONAL BUDGET OFFICE, *supra* note 10, at 32. On the effects of the marriage penalty on family formation among poor women, see MCCAFFERY, *supra* note 2, at 178-84.

Property division on divorce is restricted in many states to conventional property, such as real estate and personal property, and does not directly include human capital built up during the marriage. The paradigm of human capital is a professional degree for which the nondegree spouse sacrificed to help the degree spouse attain.<sup>244</sup> In equitable-distribution regimes, conventional property is divided, and this process is the main mechanism to achieve “equity” between the spouses apart from possible child support and alimony. Alimony is usually awarded, if at all, to allow the spouse with fewer market skills to attain such skills.<sup>245</sup> The latter, so-called rehabilitative alimony is usually quite meager, typically lasting two years, and falls far short of an equal interest in the human capital developed in the marriage.<sup>246</sup> There has been a move in divorce law to replace support payments with property division,<sup>247</sup> but property that can be divided has generally been construed rather narrowly.

The treatment of professional degrees in divorce is still very unsettled.<sup>248</sup> Most courts, except those in New York, give the nondegree spouse a debt interest in the human capital rather than an equity share.<sup>249</sup> However, if the spouse with less human capital receives less than half of the human capital on divorce, then splitting the income by halves means that income but not the underlying income-producing property has been transferred. The question is whether, on the various approaches to measuring income, half should be deemed transferred.

On an ability-to-pay approach, the fact that the spouse with less human capital is a donee does not negate the fact that the donor is exercising a heightened ability to pay in the form of control. Unless the nondegree

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244. See, e.g., *Lowery v. Lowery*, 413 S.E.2d 731 (Ga. 1992) (holding medical school education and business licenses to be an intangible asset personal to the holder and, because such asset is difficult to value and nonphysical, not subject to division on divorce); *Mocnik v. Mocnik*, 838 P.2d 500 (Okla. 1992) (holding that a husband’s interest in goodwill of his medical practice is not a divisible asset on divorce).

245. See generally Joan M. Krauskopf, *Rehabilitative Alimony: Uses and Abuses of Limited Duration Alimony*, 21 FAM. L.Q. 573, 573-75 (1988).

246. See, e.g., WEITZMAN, *supra* note 79, at 70-142; Suzanne Reynolds, *The Relationship of Property Division and Alimony: The Division of Property to Address Need*, 56 FORDHAM L. REV. 827, 866 & n.168 (1988).

247. See, e.g., WEITZMAN, *supra* note 79, at 64-67.

248. See, e.g., Daniel D. Polsby & Martin Zelder, *Risk-Adjusted Valuation of Professional Degrees in Divorce*, 23 J. LEGAL STUD. 273 (1994). For references to the large literature on the subject, see *id.* at 273 n.2.

249. See *id.* at 273-75. For example, the California Family Code provides that the community is to be reimbursed for community contributions with interest. See CAL. FAM. CODE § 2641 (West 1994). Thus, contributions by either spouse are split down the middle without regard for a net imbalance.

spouse has sufficient rights after divorce to ensure a continued benefit from the human capital—a kind of continued expectation approximating beneficial ownership—the transfer is an exercise of the donor’s ability to pay.

Under a standard-of-living measure, it might be thought that as long as both spouses enjoy the income during the marriage, the spouse with less human capital is enjoying taxable consumption. Also, under what I called the “weak” theory of control, the spouse who makes the transfer, but not the recipient, has the kind of “control” relevant for taxation.<sup>250</sup> Furthermore, marriage partners bargain for control in the shadow of legal rules, including those of property division on divorce.<sup>251</sup> Thus, if divorce law gives the spouse with more human capital more leverage during the marriage, that spouse may have a higher standard of living, or at least greater ability to pay, *during* the marriage.

If the nondegree spouse does not have this measure of control, then equal taxation of the spouses (as under joint filing) would then overtax the nondegree spouse with less human capital, and the spouse with the extra human capital would be undertaxed. Alternatively, the unequal bargaining power means that the situation of individuals in an unequal marriage is characterized by far less sharing than the assumption of sharing in a tax-paying family unit. Such an unsharing married couple may even engage in little more sharing than two unmarried individuals. In such cases, the spouse with more human capital has given up less freedom and control, and the spouse with less human capital has gained less freedom and control. Less consumption or well-being has been transferred within the marriage than the splitting approach implies.

Many problems on divorce stem from the search for a one-size-fits-all solution, just as the problems with joint and individual filing do. If we do not mandate sharing of the fruits of human capital on divorce, then, as we have just seen, less sharing may occur in the marriage than joint filing would imply. If, on the other hand, we force couples to share human capital on divorce, we face two problems. First, we preclude people from entering into less-sharing marriages if they so choose. It is not at all clear that restricting the range of choices in this way is desirable. Second, we face difficulties in how to levy the nondegree spouse’s share. If it is a lump sum, we do not have to worry about the degree spouse’s incentive to

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250. See *supra* Part II.A.2.

251. See Polsby & Zelder, *supra* note 248, at 276 & n.13; Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950 (1979).

work: The degree spouse owes the same amount whether or not, or even how much, that spouse works. But such lump-sum taxes are very difficult to convince the public to accept. If instead we force the spouse with the greater human capital to pay some portion of future wages to the other spouse after divorce, we run the risk of diminishing the spouse's incentive to work. In effect, we are raising the degree-spouse's marginal tax rate. However, if this spouse's labor-supply elasticity is relatively inelastic, taxing that spouse more heavily may not induce less work and could induce more, if the income effect predominates.<sup>252</sup>

Instead, I posit that the main objection to the forced sharing of human capital on divorce is that people take pity on the spouse with human capital having to pay after the marriage has gone bad. Such sympathy may be misguided and stem from a blatant disregard of the less-well-off post-divorce spouse. In any event, sympathizers with the degree spouse should have little quarrel with intermediate filing, because the system is voluntary even beyond the point that marriage is voluntary. Many people marry for a variety of reasons, including religious and cultural, as well as economic ones. It is not surprising that there is no consensus that merely because someone did not have to get married, she has no reason to complain about the rules for divorce, whatever they are. Instead, there is an unsurprising tendency to regard marriage as fundamental and to take burdens on it very seriously.

Intermediate filing is open to none of these objections, however. For most people, the decision to lower one's taxes does not have the religious and cultural overtones that the decision to marry does. Rather, intermediate filing presents individuals contemplating marriage with the choice to lower taxes in return for rules that mandate sharing, even of human capital, on divorce. That decision, if taken with eyes open, gives little reason to think that the consequences should be any less severe than those bargained for by the parties. Primary earners who do not want to share human capital on divorce need not negotiate a more even ratio, and their prospective secondary-earner spouses need not marry them. Consider again the analogy to liquidated damages: Absent fraud, duress, or other formation difficulties that courts already police, the presumption should be to enforce the damages for which a party bargained. In the case of intermediate filing, the ar-

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252. This result is because the higher effective tax rate makes the degree-spouse poorer and may therefore prompt more work. Because taxes lead to both an income effect and a substitution effect that work in opposite directions, nothing can be said a priori about the behavioral response to a higher tax rate. Rather we must know something about the labor supplier's elasticity. The spouse with more market skills is often the husband, with a lower elasticity. Thus, the income effect may well dominate here.

guments for liquidated damages, as well as the arguments against them, point in favor of letting intermediate filing take its course on divorce.

Intermediate filing, however, does not solve the most difficult problems of human capital on divorce. Under intermediate filing, one would total the human capital built up during the marriage and divide the fruits of it according to the prenegotiated ratio, which acts as a liquidated damages clause.<sup>253</sup> The system would require a method of valuing human capital and a method of distinguishing human capital built up before and after the marriage ends.<sup>254</sup>

Lastly, intermediate filing can be generalized to offer solutions to several other problems related to income-splitting and the marriage penalty. For example, the current system of standard deductions and the Earned Income Tax Credit present many couples with a marriage penalty.<sup>255</sup> The benefits of these could also be set up to track the prenegotiated ratio for income-splitting and property division. Similarly, the present proposal can handle the presence of children: The benefit of dependent deductions could be allocated to the secondary earner as a default and shifted fractionally to the primary earner; the proportion of the deduction going to the primary earner would rise towards fifty percent as the negotiated sharing ratio approaches 50/50. I return to the question of children in Part VI.

One further problem on divorce is the spouse's liability for taxes arising during the marriage. Under the present joint-filing system, a spouse who signed a joint return is jointly and severally liable for the taxes owed that year.<sup>256</sup> Women especially have sometimes found after divorce that their husbands did not pay their share of the tax, and the Internal Revenue Service has pursued the wife on the basis of joint and several liability. As has become clear, the "innocent spouse" provisions are insufficient to protect against many such problematic cases and time will tell whether newly enacted relief will prove effective.<sup>257</sup> Although intermedi-

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253. See *supra* Part III.D.3.

254. As for human capital built up before the marriage begins, similar questions arise, or we could just leave it to the spouses to take into account the extent they wish to share this human capital in setting the ratio, or by not opting into the system at all.

255. See CONGRESSIONAL BUDGET OFFICE, *supra* note 10, at 7-8, 15-25.

256. See I.R.C. § 6013(a) (West 1998) (providing for joint returns).

257. See *id.* § 6015 (relieving spouse of liability in certain cases). See, e.g., *Crowley v. Commissioner*, 66 T.C.M. (CCH) 1180 (T.C. 1993) (denying innocent spouse relief), *aff'd* by *Cockrell v. Commissioner*, 116 F.3d 1472 (2d Cir. 1997) (table), *cert. denied*, 118 S. Ct. 1163 (1998). See generally, e.g., Richard C.E. Beck, *The Innocent Spouse Problem: Joint and Several Liability for Income Taxes Should Be Repealed*, 43 VAND. L. REV. 317, 348-69 (1990); Jerome Borison, *Alice Through a*

ate filing is not the only way to solve the problem of joint and several liability, it does present a particularly natural solution. If we use a default individual-filing system, property income could be taxed in proportion to earned income, or, with more difficulty, to the "owner." Spouses would then be responsible for that portion of the tax that is "theirs." Under the self-assessed ratio, matters are even simpler. Spouses are responsible for the tax liability on their respective percentages of the household income.

The voluntary nature of the self-assessed ratio under intermediate filing also provides an answer to the possible objection that family law, and divorce law in particular, are traditionally matters for the states, not for the federal government. To gain maximum advantage out of intermediate filing, it could be imposed across the country despite objections from the states. Somewhat less intrusively, individuals opting in the system might be required to negotiate the ratio in such a manner that it would be respected as a valid antenuptial agreement with an enforceable liquidated damages provision. If we accept the proposition that family law has been traditionally left to the states,<sup>258</sup> the intermediate-filing system can be made voluntary in a second sense: Individual states can be allowed to decide whether they will pass enabling legislation to give the self-assessed ratio from intermediate-filing effect in their divorce law. This is a minor step, because the self-assessed ratios would function much like antenuptial agreements, which already are typically given substantial deference. In any event, a state could choose not to opt into the system and thereby force its residents to use default individual filing.<sup>259</sup> Indeed, we could use any default system we wished for the states that did not opt into the intermediate-filing system. But if we wanted to have an incentive for the citizens to opt in, it should lead to higher taxes for many couples than they could achieve with a self-assessed ratio under individual filing.<sup>260</sup> Thus, the de-

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*Very Dark and Confusing Looking Glass: Getting Equity from the Tax Court in Innocent Spouse Cases*, 30 FAM. L.Q. 123 (1996).

258. As Jill Hasday points out, the historical evidence for this "tradition" is surprisingly slim. See Jill Elaine Hasday, *Federalism and the Family Reconstructed*, 45 UCLA L. REV. 1297 (1998).

259. The system thus presents the states with incentives to adapt their marital property laws without forcing a one-size-fits-all solution. Pamela Gann has noted that, if we combined individual filing with income-splitting for those in states adopting a system like community property, states would have an incentive to adopt such reforms. See Gann, *supra* note 2, at 49-52. However, community property does surprisingly little to guarantee sharing. See *infra* Part V. Further, even if community property did enforce equal sharing, a choice of individual filing or a community-property system would provide an all-or-nothing choice without assurances that people would opt into community property. Intermediate sharing would be mismeasured.

260. For example, using pure joint filing (leading to the lowest taxes for any couple) would sap any incentive for a state to opt into the intermediate-filing system: Couples, and primary earners in

fault for states not opting in must be some form of individual filing, but the choice between that and intermediate filing can be left up to them.

In addition to the advantages of making the treatment of human capital on divorce more straightforward because it is more voluntary, intermediate filing has further potential benefits for family law and the institution of marriage. These benefits are closely tied to some of the equity and efficiency considerations discussed earlier.

Intermediate filing will strengthen women's bargaining position both before and during marriage. The penalty default will favor the economically less-secure prospective or actual spouse—typically the woman—and will strengthen that party's hand. To get the advantages of income-splitting, the husband, for example, will have to offer more genuine and greater sharing than he would otherwise. Furthermore, if he negotiates a more even, tax-lowering ratio, then the wife will be entitled to more on divorce. This will mean that during the marriage, she can demand more: If not satisfied, she can leave and will be better off than she typically would be if she left under today's law. In economic terms, her "reservation utility" and hence her bargaining power will have increased. Furthermore, by making division on divorce simpler, this reservation utility will be even higher because the cost of divorce will be less, and the lower the cost of divorce, the more the wife will receive from the divorce.

A final question about this system and its relation to family law and marriage is whether it unduly "commodifies" domestic labor and marriage itself.<sup>261</sup> Here, we can point to both the voluntariness of intermediate filing and, more importantly, to the fact that couples would be negotiating a ratio rather than a dollar value. The system does not tell spouses to work out a wage for domestic service, although marital sharing often has that behavioral effect. Instead, it asks them if they would like a single ratio that is favorable for overall household taxes that would also apply on divorce. In effect, the couple is being asked whether they would like their sharing legally recognized *and enforced* beyond the minimum level mandated by marriage law. The spouses (and others) are free to think of the

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particular, could not lower their taxes more under intermediate filing than they already could if their state opted for default joint filing.

261. See, e.g., Elizabeth S. Anderson, *Is Women's Labor a Commodity?*, 19 PHIL. & PUB. AFF. 71, 80-87 (1990) (arguing for incommensurability of women's labor); Staudt, *supra* note 53, at 1631 (noting critique for "commodification" of valuation of housework for taxation). See also MARGARET JANE RADIN, *CONTESTED COMMODITIES* (1996); Margaret Jane Radin, *Market-Inalienability*, 100 HARV. L. REV. 1849, 1885 (1987). But see Katherine Silbaugh, *Commodification and Women's Household Labor*, 9 YALE J.L. & FEMINISM 81, 120-21 (1997) (arguing that commodification critique has less force in nonmarket situations in which economic analysis can often benefit women).

sharing as exchange or gift or something else. What is important is that the amount of sharing of control is not murky and that the resulting tax regime has desirable behavioral effects, because of the way it taxes marital exchange and gifts to the extent *either* occurs.

#### F. (RELATIVE) SIMPLICITY

Intermediate filing can go a long way towards reducing the incentive to engage in property transfers in order to lower taxes. One of the advantages of joint filing over individual filing is that apparent ownership of assets by the wife, the husband, or both does not matter as far as income tax rates are concerned. Individual filing has the potential of emulating joint filing in this positive respect.

Consider first the case of a couple who has opted into the self-assessed intermediate system. Whatever ratio they negotiate applies to *all* household income. If they negotiate a 60/40 ratio, then sixty percent of the household income is taxed to the one spouse and forty percent to the other. Who has title to property is not relevant for divorce or for tax purposes. There is no tax-effect of manipulating legal title because tax-ownership, as well as true ownership, in an important sense is determined by the negotiated ratio.

Now consider a couple that stays with the default. Assuming that this default is individual filing, then we have the familiar problem of how to tax this couple on property income. This problem is not as important as it seems, however, because there is usually a lot less property income in a marriage than earned income from human capital. For the default filers, however, we might wish to tax property income in proportion to earned income or to the higher earning spouse. Either would give the penalty default more bite and avoid the tax incentive to manipulate the indicia of ownership. As noted earlier, the nature of the default is not as important as that it be less attractive from a tax point of view than a negotiated, more even ratio.

Alternatively, for the default we might use the mirror image of the self-assessed ratio. That is, we might say that for tax purposes, ownership counts in default individual filing but use a *recapture rule* for tax purposes on divorce. Consider the situation in which there is a divorce that makes it clear that true ownership is not tracking prior tax ownership. The better-off spouse is doing better out of the divorce than it appeared on paper for tax purposes during the marriage. The recapture rule would recoup from that spouse for the Treasury the benefits of the tax savings from the false

appearance of greater equality in the marriage. Thus, if the indicia of ownership during the marriage causes the couple to be treated as a 60/40 couple under default individual filing, but on divorce the division reflects an 80/20 ratio in favor of the better-off spouse (the sixty percent spouse for tax purposes during the marriage), the better-off spouse is responsible for returning the tax savings (plus interest) that resulted from the 60/40 ratio as opposed to an 80/20 treatment.

Admittedly, such a system of recapture rules would be more complicated than taxing property in proportion to earned income. Arguably it would be fairer, however, and like taxation by the earnings ratio, it does preserve the penalty-default nature of the individual-filing part of the system. It also does not interfere with divorce law, because the recapture rule does not mandate any division on divorce. It only attaches tax consequences to such divisions where such divisions call into question the validity of previous tax treatment.

In this way, the default would function very much like a well-established judicial recapture rule: the "Tax Benefit" Rule.<sup>262</sup> The inclusionary side of the Tax Benefit Rule subjects amounts previously but incorrectly deducted to later tax at the point when the incorrectness becomes apparent. Like the Tax Benefit Rule, the recapture rule would recoup tax where a previous lower tax turns out later to have been based on a false assumption.

Finally, like the self-assessed ratio that such a default-using couple has chosen not to use, this tax-benefit-type recapture rule would help ensure that tax treatment tracks the amount of sharing occurring in the marriage. This is not surprising because the recapture-rule approach to default individual filing is, in some sense, the mirror image of the self-assessed ratio that the couple could have negotiated. In default individual filing, the recapture rule ensures that the couple is paying enough tax by recouping it later with interest, if necessary, whereas with the self-assessed ratio, the ratio negotiated for tax purposes is used on divorce.<sup>263</sup> What separates the

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262. See *Hillsboro Nat'l Bank v. Commissioner*, 460 U.S. 370 (1983) (holding that an earlier deduction or credit is subject to recovery if a "later event [occurs that is] fundamentally inconsistent with the premise on which the deduction was initially based"). See also, e.g., Matthew J. Barrett, *Determining an Individual's Federal Income Tax Liability When the Tax Benefit Rule Applies: A Fifty-Year Checkup Brings a New Prescription for Calculating Gains, Adjusted Gross, and Taxable Incomes*, 1994 B.Y.U. L. REV. 1; Wm. D. Elliott, *The Tax Benefit Rule: A Common Law of Recapture*, 39 SW. L.J. 845 (1985); Patricia D. White, *An Essay on the Conceptual Foundations of the Tax Benefit Rule*, 82 MICH. L. REV. 486 (1983).

263. The recapture rule previously discussed as a method for introducing flexibility into the self-assessed ratio of intermediate filing raises entirely different issues. See *supra* Part III.B.

two is that the self-assessed ratio would be much easier to administer: The recapture rule in connection with default individual filing would require very complicated audits. Further, it is much easier to be strict with those who have negotiated a ratio than those who could plausibly plead ignorance at the time they owe tax on divorce. Thus, the case for the self-assessed ratio itself is far stronger than for the use of tax-benefit-type recapture rules on divorce. In light of this, for purposes of default individual filing, taxing property income in proportion to the spouses' earned income or taxing it to the primary earner might be better on balance than the tax-benefit-type of recapture rule.

#### IV. CONTROL AND INCOME SHIFTING IN THE HISTORY OF HOUSEHOLD TAXATION

Recognizing intermediate filing as an option allows a better understanding of the history of tax law's treatment of married couples. Conversely, this history confirms the central role played by the assumption that the polar alternatives of joint or individual filing are the only possible ways to tax the income of married couples. Further narrowing the alternatives along the way, Congress, the courts, and commentators often assume that whatever approach tax law took to income-splitting would be based on *existing* property- and family-law categories. In the process, the tax law has lurched from one extreme to another. However, the changeability of those categories in response to tax law and the limits of that changeability both demonstrate on a legislative level the countervailing incentives upon which this Article's proposed system of intermediate filing is built.<sup>264</sup>

##### A. INCOME-SPLITTING, STATE PROPERTY LAW, AND "PENALTY" AVOIDANCE

In 1913, Congress introduced the solution advocated by most commentators today: individual filing.<sup>265</sup> Because married taxpayers wished to lower their taxes through income-splitting, they tried a number of devices and legal theories that if accepted by the courts would have achieved the

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264. For previous discussions of the history of marital taxation from perspectives other than the possibility of intermediate filing and the source of ownership notions for the tax law, see, e.g., GRAETZ, *supra* note 2, at 30-34; MCCAFFERY, *supra* note 2, at 29-85; Bittker, *Taxation and the Family*, *supra* note 2, at 1399-1416; Gann, *supra* note 2, at 10-24.

265. See Tariff of 1913, Pub. L. No. 63-16, ch. 16, § II(A)(1), 38 Stat. 114, 166. Joint filing was first recognized in 1918, but because the same rates were applied to individual and joint returns, it was almost invariably disadvantageous to file jointly. See Bittker, *Taxation and the Family*, *supra* note 2, at 1400 & n.20.

desired effect. In the period between the beginning of the Depression and the end of World War II, the Supreme Court decided a number of cases that raised issues of income-splitting and the definition of ownership but did so in a seemingly arbitrary or even contradictory way. Under the conventional view, the Court in *Lucas v. Earl*<sup>266</sup> appeared to endorse the protection of progressivity, but *Poe v. Seaborn*<sup>267</sup> allowed progressivity to be eroded through income-splitting in community-property states. The Court in *Seaborn* seemed to have embarked on a program of deference to state property law and only later, in the 1940s, to have pulled back towards protecting progressivity again in the marital income-splitting area.

In this section, I will argue that the *Seaborn* decision is not best seen as a serious answer to the question of ownership for purposes of income taxation, as is often expected. Instead, I will argue that *Seaborn* is better explained as arising from the interaction of the Court's reluctance to define tax ownership on the one hand and the Court's use of existing state property- and family-law categories as crude devices to avoid a marriage "penalty." I will argue that what appears to be deference to state property law concepts results from the Court's wish to avoid defining ownership and its desire to prevent any situation in which a taxpayer, especially a man, would wind up paying more tax than the taxpayer would as an individual.

#### 1. *Income-Splitting Arrangements: Lucas v. Earl*

The Supreme Court rendered its first major pronouncement on voluntary income-splitting in *Lucas v. Earl*. In that case, Mr. and Mrs. Earl had arranged by contract that every acquisition of property by either spouse and all proceeds of any property of either spouse would be taken as joint tenants with the right of survivorship.<sup>268</sup> The Court assumed that this assignment was valid under the law of California, where the Earls resided. The effect of the arrangement was to allow the Earls to engage in income-splitting (of the pure kind later allowed between 1948 and 1969). In particular, Mr. Earl's earned income would not be subject to as high a rate as before the assignment but instead would, along with other income, be taxed half to his wife. Each would pay the tax on half of the aggregate household income. Not surprisingly, the Commissioner objected to this result.

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266. 281 U.S. 111 (1930).

267. 282 U.S. 101 (1930).

268. See *Earl*, 281 U.S. at 114.

In a brief opinion by Justice Holmes, the Court sidestepped the question of whether Mr. Earl ever owned the assigned portion of the earned income.<sup>269</sup> Rather, the Court focused exclusively on the policy of the income tax:

There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contacts however skilfully [sic] devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew.<sup>270</sup>

Since the *Earl* case, the fruit-and-tree metaphor unfortunately has been taken to mean that a complete transfer of property means no taxation of the transferor but a transfer of a “carved out” interest does lead to taxation of the transferor.<sup>271</sup> Nevertheless, Holmes was using the metaphor in advocating an interpretation of the Internal Revenue Code as taxing the *source* of income. In particular, the Court took the Code to mean that earners are taxed regardless of what happens to the earned income later, especially if the income ends up with a lower-bracket taxpayer.

*Earl* can be regarded as a method of preventing tax avoidance through income-shifting on the assumption that married individuals should be treated as individuals.<sup>272</sup> If so, the problem is its narrowness. Shifting earned income is prevented but shifting of income from property is allowed. As noted in Part II, one of the major drawbacks to individual filing is the ability to shift around property income to give the false appearance of sharing in order to lower the primary earner’s and the couple’s overall

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269. That is, the Court avoided addressing the issue of whether under the assignment the income flowed through Mr. Earl’s hands or whether the assignment had the effect of creating for Mrs. Earl one-half ownership in the income the instant it was earned by Mr. Earl.

270. *Earl*, 281 U.S. at 114-15. The statutes in question were the Revenue Act of 1918, see Pub. L. No. 65-254, §§ 210-211, 212(a), 213(a), 40 Stat. 1057, 1062-64, 1065 (1919), and similar provisions in the Revenue Act of 1921, see Revenue Act of 1921, ch. 136, §§ 210-211, 212(a), 213(a), 42 Stat. 227, 233-38. In particular, section 213(a) of the 1918 Act provided for taxation of net income of every individual including “income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid.” Revenue Act of 1918 § 213(a).

271. Compare *Blair v. Commissioner*, 300 U.S. 5 (1937) (holding that assignment of the right to receive income from trust was transfer of property, the income of which would not be taxable to the donor) with *Helvering v. Horst*, 311 U.S. 112 (1940) (holding that a gift of coupon on a bond is transfer of income that remains taxable to the donor).

272. See Bittker, *Taxation and the Family*, *supra* note 2, at 1401-04 (pointing out that *Earl* only “guards” progressivity if one assumes that married people should not be subject to a lower rate because of marriage).

taxes. If preventing income-shifting is correct for earned income, some effort should be made to prevent shifting of income from property. As discussed earlier, intermediate filing, unlike individual filing, accomplishes this by using a single ratio for splitting all earned and property income for both tax and divorce purposes.

## 2. *Income-Splitting Under Community Property: Poe v. Seaborn*

Community-property systems presented the Court in the term after *Earl* with an income-splitting situation very similar to the one the Earls sought to achieve by means of their individual arrangement. In ruling on the income-splitting effected by Washington's community-property system, the Court took an entirely different approach to splitting than it had in *Earl*. The Court made the availability of splitting rest on state marital property law. I suggest that this anomalous result derived from the Court's desire to avoid a marriage "penalty."

In *Poe v. Seaborn*, the Seaborns were residents of Washington and tried each to pay half of the tax on their aggregate income. The situation was artificially simple, because "[w]hile the real estate stood in [the husband's] name alone, it is undisputed that all of the property real and personal constituted community property and that neither owned any separate property or had any separate income."<sup>273</sup> Since separate property is property held by either member of the entire community rather than by the community and is kept by the separate owner on divorce,<sup>274</sup> the fact that there was no separate property made the issue in *Seaborn* deceptively simple. The choice was between allowing complete splitting of all income or taxing it on the basis of some other notion of "ownership."

The notion of ownership advanced by the Commissioner was based on the so-called "control test": Who had such control over the property that the individual in effect owned it? The Commissioner relied on three cases, *United States v. Robbins*,<sup>275</sup> *Corliss v. Bowers*,<sup>276</sup> and *Lucas v. Earl*.<sup>277</sup> In each of these cases, a high-bracket taxpayer was prevented from lowering the rate applied to his income by means of a transfer of income to a lower-bracket individual. Further, the *Robbins* case seemed quite close to the *Seaborn* situation because it involved community property. Justice Holmes' opinion for the Court in *Robbins* emphasized the

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273. *Poe v. Seaborn*, 282 U.S. 101, 109 (1930).

274. *See infra* Part V.A.1.

275. 269 U.S. 315 (1926).

276. 281 U.S. 376 (1930).

277. 281 U.S. 111 (1930).

extensive powers of management and control of the husband as indicating ownership and hence taxability.<sup>278</sup> The *Seaborn* Court nevertheless distinguished *Robbins* on the ground that California itself, the state of the taxpayers' residence, regarded the wife's interest in community property as a "mere expectancy." Under California law, she did not own the property or the income and would not be taxed. Instead, her husband would be taxed. But Holmes' opinion in *Robbins* had explicitly stated that the law of California did *not* matter but rather that the tax act taxed those with control.<sup>279</sup> The Court's complete reinterpretation of *Robbins* in *Seaborn*, which was unanimous with Holmes' vote, was also curious in light of *Earl*. There, Justice Holmes had explicitly denied that the subtleties of property-law vesting should determine the availability of splitting. Thus, the method of distinguishing *Robbins* was at odds with the reasoning of both *Robbins* and *Earl*.

The *Seaborn* Court ignored the reasoning in *Robbins* and *Earl*, and reinterpreted it as based on the very subtleties of state-law vesting that Justice Holmes had consistently downplayed. In *Seaborn*, the Court claimed that the issue in *Earl* was precisely whether there was any vesting because:

[t]he very assignment in that case was bottomed on the fact that the earnings would be the husband's property, else there would have been nothing on which it could operate. That case presents quite a different question from this, because here, by law, the earnings are never the property of the husband, but that of the community.<sup>280</sup>

The *Earl* Court, however, had indicated that even if an arrangement prevented the "salary when paid from vesting even for a second in the man who earned it,"<sup>281</sup> the arrangement would not prevent the earner from being taxed, because that seemed to the Court the "import of the statute."<sup>282</sup> In other words, *Earl* directs attention to who the earner is as a matter of interpretation of the federal statute regardless of the state-law technicalities of vesting and ownership. Implicit in earning income is a degree of control over it, which Mr. Earl had exercised in assigning half of it to his wife. The *Seaborn* Court, however, made the result in *Earl* turn on those newly-resurrected technicalities.

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278. See *Robbins*, 269 U.S. at 327.

279. See *id.*

280. *Seaborn*, 282 U.S. at 117.

281. *Earl*, 281 U.S. at 115.

282. *Id.*

The Court in *Seaborn* also needed to distinguish the case of *Corliss v. Bowers*.<sup>283</sup> In that case, the donor of a gift in trust was nonetheless regarded as the owner for income tax purposes because he exercised sufficient control over the trust. Again, a case that directed attention to Congress' purposes in order to determine ownership for taxation was confined to its result.<sup>284</sup> The Court in *Seaborn* merely asserted that the Court in *Corliss* had found that Congress declared the donor was still the owner for tax purposes, but that in the *Seaborn* case the husband "never ha[d] ownership."<sup>285</sup> This begged the question of *how tax ownership is to be determined*. In *Corliss*, *Earl*, and arguably *Robbins*, the Court attributed an intent to Congress to tax those who exercise control over income, including, but not limited to, those who earn (and hence control) it.

One reason the control test may have appeared unattractive to the Court in *Seaborn* is that the Commissioner was not just claiming that the husband should pay tax on all of the income arising from his labor and over which he retained control. The Commissioner did not use a source-based theory at all. Instead, the Commissioner took the position that, since the husband had the power to manage all the community assets and income,<sup>286</sup> he should be taxed on the *whole* of the community's income.

In other words, the Commissioner was advancing a theory whose effects would have closely tracked those of a 1941 House proposal.<sup>287</sup> Under that proposal, each married couple would aggregate their income and pay as much as a *single person* would on the same amount. The proposal was not very popular. Opponents branded it a "tax on morality."<sup>288</sup> The Commissioner's position in *Seaborn* would have had the same result: The community would pay as much tax on its aggregate income as the husband would if all the income were his as an individual.

The Court, therefore, faced a three-way choice. It had to accept the income-splitting in community-property states that the taxpayers' desired, insist on income aggregation on single rates (the Commissioner's position), or the Court had to come up with a third theory not advanced by ei-

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283. 281 U.S. 376 (1930).

284. Congress has since introduced rules for the treatment of trusts into the Internal Revenue Code as reflected in § 641 to § 683. See I.R.C. §§ 641, 644-645, 663-665, 672, 674, 679 (West Supp. 1998); *id.* §§ 642-643, 668 (1994 & Supp. II 1996); *id.* §§ 651-652, 661-662, 666-667, 670-678, 681-683 (1994).

285. *Seaborn*, 282 U.S. at 117.

286. This includes even the income from his wife's assets, and, if present, income from the wife's labor.

287. See H.R. REP. NO. 77-1040, at 420-21 (1941), reprinted in 1941-42 C.B. 413.

288. See Bittker, *Taxation and the Family*, *supra* note 2, at 1409.

ther party. For example, it could have developed the “source” aspect of *Earl*, such that sources of income would be taxed; this would treat those in community-property states for tax purposes as if they were in a common-law property state.<sup>289</sup> The source treatment would have required developing a federal concept of ownership for the Internal Revenue Code.<sup>290</sup> Developing such a concept of ownership would only have highlighted the artificial distinction from *Earl* between earned income and income from property.

Of these choices, the Commissioner’s position of income aggregation on single rates likely seemed extreme for the reasons that the 1941 House proposal was viewed unfavorably. The Commissioner’s position makes sense today: If the community property statute does not give the wife control, why not tax the husband?<sup>291</sup> In the early 1930s, though, the Court probably sympathized with the husband facing a marriage “penalty.” Since the Depression was a time when employers routinely reserved jobs for male “breadwinners,”<sup>292</sup> the Court probably believed that such a “penalty” was unfair.

Developing a source-based theory would have required a federal definition of ownership for income taxation, which would have necessitated some motivation in terms of the purposes of the income tax statute. These requirements would have been difficult to meet in light of the artificiality of the Court’s own distinction between income from services and income from property. The new definition of ownership for taxation that the Court developed would raise the question why one can shift income from property but not income from personal labor.

The easy way out was to defer to state ownership rules. The Court accepted income-splitting for community-property states only; for others, *Earl* would still govern. This choice was dictated not by an acceptance of

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289. The source aspect of *Earl* is probably most popular today, in part because it supports individual filing. See, e.g., Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 357.

290. Alternatively, the Court could have compromised between the Commissioner’s pure control theory and taxed personal-service income to the spouse who earned it and investment income to the spouse to whom state law gave the right to manage and control it. This was the approach of the later 1941 Senate Proposal. See S. REP. NO. 77-673, at 466, 474-76, 494-95 (1941), *reprinted in* 1941-42 C.B. 470.

291. These days, such a statute giving the husband control would not be acceptable; but given such control, most would favor taxing the husband with that control. Cf. Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 354-58 (arguing that tax should follow control and that therefore individual filing is appropriate).

292. See, e.g., Nancy E. Dowd, *Work and Family: Restructuring the Workplace*, 32 ARIZ. L. REV. 431, 436 & n.27 (1990); Deborah L. Rhode, *Perspectives on Professional Women*, 40 STAN. L. REV. 1163, 1172 & n.49 (1988).

the proposition that the policies behind state marital property law were congruent with those of the Code on the income-splitting question. Instead, allowing income-splitting in community property was the only choice as long as the Court did not want to define ownership for tax purposes itself and wished to avoid steep marriage “penalties” in community-property states. As we will now see, in striking confirmation of this view, when the threat of such a marriage penalty had passed, so would the Court’s use of community property law in the income-splitting area.

### 3. Deference to State Property Law

The Court’s deference to state property law seems to foreshadow other cases in the line starting with *Blair v. Commissioner*.<sup>293</sup> On closer inspection, these cases pose apparent problems for regarding *Seaborn* as a pure case of deference to state property law. Developments after *Seaborn* reinforce the view that the *Seaborn* Court’s objective was to avoid a marriage “penalty” on husbands and that “deference” to state law was only a means to that end.

In *Blair*, a beneficiary of a trust made a series of assignments of income to his children and claimed that not he but the assignees, who were presumably subject to a lower marginal tax rate, should pay the tax on the assigned income. The Court relied on *Seaborn* for the proposition that “the tax is upon income as to which, in the general application of the revenue acts, the tax liability attaches to ownership.”<sup>294</sup> The Court found that the assignments were valid as a matter of local (Illinois) law<sup>295</sup> and that “nothing in the revenue acts . . . denies [the assignee] [the] status [of owner].”<sup>296</sup>

The problem becomes how to distinguish property and income. In *Helvering v. Horst*,<sup>297</sup> the Court decided that transferring the unmatured coupons of a bond was an assignment of *income*, not “property.” The Court asserted that “[t]he holder of a coupon bond is the owner of two independent and separable kinds of rights,”<sup>298</sup> the right to receive the principal back and the right to receive periodic interest payments according to the terms of the coupons. The Court used the *Earl* control test to find the donor to be the owner and hence taxable:

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293. 300 U.S. 5 (1937).

294. *Id.* at 12.

295. *See id.* at 10.

296. *Id.* at 12.

297. 311 U.S. 112 (1940).

298. *Id.* at 115.

Underlying the reasoning in [previous] cases is the thought that income is “realized” by the assignor because he, who owns or controls the source of the income, also controls the disposition of that which he could have received himself and diverts the payment from himself to others as the means of procuring the satisfaction of his wants . . . .

Although the donor here, by the transfer of the coupons, has precluded any possibility of his collecting them himself, he has nevertheless, by his act, procured payment of the interest as a valuable gift to a member of his family. Such a use of his economic gain, the right to receive income, to procure a satisfaction which can be obtained only by the expenditure of money or property, would seem to be the enjoyment of the income whether the satisfaction is the purchase of goods at the corner grocery, the payment of his debt there, or such non-material satisfactions as may result from the payment of a campaign or community chest contribution, or a gift to his favorite son.<sup>299</sup>

The Court came close to a federal definition of ownership, stating flatly that “[t]he power to dispose of income is the equivalent of ownership of it”<sup>300</sup> and that “[t]he dominant purpose of the revenue laws is the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid.”<sup>301</sup> *Blair* was distinguished as being about donating “property” as opposed to “interest or wages,”<sup>302</sup> but the Court did not explain why this distinction should matter.

In the marital context, the question remained why a similar “gift” or transfer of earned income to a spouse under community property does not constitute an enjoyment of the income, particularly where the primary earner retains a high degree of control and where the members of the marital community retain a great degree of freedom to convert separate property into community property and vice versa.<sup>303</sup>

#### 4. *The Reemergence of a Modified Control Test*

By the end of World War II, however, the Court’s approach to marital income had begun to move away from deference to state property law. By that time, however, a marriage penalty of the sort avoided by the *Seaborn* decision had been rejected by Congress in the early stages of Congress’ move from one polar extreme of individual filing to the other extreme of joint filing.

299. *Id.* at 116-17.

300. *Id.* at 118.

301. *Id.* at 119.

302. *Id.* at 118-19.

303. *See infra* Part V.A.

After the *Seaborn* decision, many states sought to secure for their citizens the advantages of income-splitting by adopting a community-property system. Oklahoma gave its citizens a choice of opting into a community-property scheme, and the tax effect on those who chose this option was the issue presented in *Commissioner v. Harmon*.<sup>304</sup> This time the Commissioner took the position that the husband was taxable on his income from separate property and on all his earnings, but not taxable on income from his wife's separate property. Mr. Harmon and both the lower courts viewed the case as falling under *Seaborn*: Income-splitting effected by a community-property system was to be respected for tax purposes. The Supreme Court, however, claimed that the "community system of Oklahoma [was] not a system, dictated by State policy, as an incident to matrimony."<sup>305</sup> The Court emphasized that the system was not an "inveterate policy" in Oklahoma unlike in other community-property states.<sup>306</sup> The Court was willing to assume that Oklahoma state law made the property one-half Mrs. Harmon's<sup>307</sup> but was unwilling to defer to that division for tax purposes.

Thus, after *Harmon*, the Court was advocating two theories of income tax liability, as Justice Douglas pointed out in his dissent.<sup>308</sup> Contemporaries too recognized that there was nothing "consensual" or "voluntary" that separated the Oklahoma scheme from community property in other states. Marriage itself was a consensual act,<sup>309</sup> and in many community-property states, husband and wife could use antenuptial agreements to avoid the community-property scheme or could contract around it once in the marriage. Furthermore, separate property was preserved as separate unless converted by contract into community property.<sup>310</sup> Thus, as contemporary commentators were quick to point out, the only difference between *Seaborn* and *Harmon* was an act-omission distinction. Taxpayers like the Seaborns could split income because they could allow the community-property system to give them the result they wanted, although they could achieve a different result by contract.

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304. 323 U.S. 44 (1944).

305. *Id.* at 48.

306. *Id.* at 46.

307. *Id.* at 47.

308. *See id.* at 56 (Douglas, J., dissenting).

309. *See id.* at 53 (Douglas, J., dissenting).

310. *See, e.g.,* Willard S. Pedersen, *Application of Federal Income, Estate and Gift Tax Laws to Community Property*, 45 MICH. L. REV. 409, 414, 423 (1947). Further contemporary commentary regarding this line of case law also focused on the resulting disparity in tax liability between those states with mandatory community-property systems and those states without such a system. *See id.* at 412 n.4.

The choice of whether to invoke *Earl* and *Harmon*, on the one hand, or *Seaborn* and *Blair* on the other, was to be made on arbitrary and shifting grounds. In *Earl*, as long as there was an act stemming from control, the interaction of the act, such as an agreement to assign the income, with a state's property law was irrelevant. Even if the income did not rest for a moment with the husband, the assignment did not affect the husband's liability for tax. In *Seaborn*, the operation of a state scheme with much the same effect *did* allow income-splitting, even though the members of the community retained a good deal of power to contract around it.<sup>311</sup> Thus, what seems to separate the application of two very different rules is the act-omission distinction. Regardless of how much control the parties possess, if the unimpeded operation of an off-the-rack state-law device led to a particular result, the Court would take that as the result for taxation following *Seaborn*, but if the parties have to do something beyond the historical minimum, the control test was to be used in accord with *Earl* and *Harmon*.

Thus, the *Harmon* Court seemed to reestablish the control test while employing a different and far less satisfactory definition of "control." Instead of asking—as did the Court in *Robbins* and *Corliss* and, in part, *Earl*—which spouse had control through management and disposition powers and the like, the Court looked to whether the couple as a whole had to exercise control by performing an overt act to gain the advantages of income-splitting. While the first sense of "control" might correspond to a sensible notion of ownership and taxable well-being, the second *Harmon*-type control does not correlate with any notion of ownership or any other proxy for taxable well-being.<sup>312</sup>

*Harmon*, however, can be explained in light of events intervening between it and the earlier *Seaborn* decision. In *Seaborn*, the Court was faced with a choice of (i) leaving the door open to a marriage "penalty," (ii) "deferring" to a state property law concept, or (iii) developing a tax concept of ownership. In the meantime, the Commissioner's position in *Seaborn*, summing both spouses' incomes and applying to that sum the same rate as would apply to individuals, lost its force with the repudiation of the 1941 House Proposal. The failure of that proposal could be viewed as a clear expression on the part of Congress not to allow the marriage "penalty" that would result from stacking marital incomes and subjecting them to the same rates that an individual with the same income would face.

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311. See *infra* Part V.A.

312. Presently, talk of "control" is invariably in the sense of power of the spouse over the resource, not in the sense of *Harmon*. See *supra* Part II.A.2.

When that danger passed, there was no longer a need to avert it through deference to state property law. The *Harmon* decision, although bizarre, indicated an end to deference to state property law in the marital area once the threat of a marriage “penalty” had receded.<sup>313</sup>

Thus, the *Harmon* decision confirms a view of *Seaborn* as a marriage-penalty avoidance case rather than as a property-concept case. The voluntary scheme in *Harmon* was no less a property system than state trust law and no more voluntary. But once the danger of a marriage penalty had passed, the marriage and property cases began to diverge. Of the competing theories of income taxation, the one that avoids a marriage penalty was no longer so necessary and was therefore relegated to the backseat.

Thus, the Court’s use of state property law was less a matter of principle than one of convenience in the face of what it viewed as extreme alternatives. As this Article argues, the historical focus on joint and individual filing, which is itself sustained by a lack of tax definitions of ownership, pushed the Court to “defer” to state law in a highly inconsistent way. Nor did the matter rest there. After *Harmon*, the Court’s job of preventing a harsh version of joint filing was complete, but Congress continued to work towards “reform,” which led to the pure joint-filing system of 1948 to 1969.<sup>314</sup> Singles’ protests against the resulting singles’ penalty gave us the system of joint filing with somewhat unfavorable rates that we have today.<sup>315</sup>

That the tax law has instantiated at one time or another just about every variant of individual and joint filing suggests that we may never achieve equilibrium at either pole. In light of the tortuous path that brought the tax law to where it is now, it is worth reconsidering the tacit commitment to polar systems that inevitably fails to reflect the degree of sharing in marriages.

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313. *Harmon* slowed but did not halt the stampede of states to adopt community-property systems in order to take advantage of the *Seaborn* decision. See *Druker v. Commissioner*, 697 F.2d 46, 48 (2d Cir. 1982).

314. See Revenue Act of 1948, ch. 168, 62 Stat. 110, 114-16. See also Bittker, *Taxation and the Family*, *supra* note 2, at 1412-14 (discussing the effects of the portion of the Revenue Act of 1948 dealing with joint returns); Stanley S. Surrey, *Federal Taxation of the Family—The Revenue Act of 1948*, 61 HARV. L. REV. 1097, 1103-06 (1948) (discussing circumstances that led Congress to adopt the Revenue Act of 1948).

315. See Tax Reform Act of 1969, Pub. L. No. 91-172, § 803, 83 Stat. 487, 678 (codified as amended at I.R.C. § 1 (West Supp. 1998)). See also S. REP. NO. 91-552, at 260 (1969), reprinted in 1969 U.S.C.A.N. at 2299; GRAETZ, *supra* note 2, at 31-35 (describing singles’ protest to the singles’ penalty and the resulting marriage penalty); MCCAFFERY, *supra* note 2, at 62-64 (describing the singles’ penalty and the resulting modern rates schedules).

## B. SOURCES OF OWNERSHIP CONCEPTS FOR THE CODE

This discussion thus far suggests that *Seaborn* is best seen not as an endorsement of using community-property categories for income taxation or even as the true beginning of the *Blair*-type property-versus-income line of cases but rather as an attempt to forestall a marriage penalty. Nevertheless, using community property as a basis for taxing the income of married couples is one of the alternative methods of allowing income-splitting. In the continued discussion below, I argue that community property, like other existing property- and family-law categories, does not furnish an appropriate proxy for sharing that is readily translated into a system for income-splitting in the income tax. Before turning to a closer analysis of income-splitting based on the category of community property, it is worth noting the serious problems that the *Seaborn* decision generated and how those problems would also be addressed by intermediate filing.

First, as the *Seaborn* Court recognized, the decision caused a radical geographical diversity in the level of income tax paid by similarly situated couples in community and non-community property states.<sup>316</sup> The Court brushed off this concern as irrelevant to its decision,<sup>317</sup> but the decision provoked a stampede of states to the community-property system<sup>318</sup> before Congress in 1948 adopted the joint return provision across the board.<sup>319</sup> After 1948, people in all states would be taxed in accordance with income-splitting of a type that previously had only been available to couples in community-property states. Interestingly, many of the new converts among community-property states reverted to common-law property regimes after there was no more tax advantage to community property.<sup>320</sup>

Second, there is no guarantee that the policy, if any, behind a state's community property law will relate to that state's income tax policy. More precisely, there is no necessary relationship between the community-versus-separate-property distinction and the extent to which we would want to allow income-splitting. *Seaborn* presents an instance of a much larger problem: the lack of a single concept of ownership for the Code.<sup>321</sup> As Noël Cunningham and Deborah Schenk have pointed out, Congress has

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316. See *Poe v. Seaborn*, 282 U.S. 101, 117 (1930).

317. See *id.* at 117-18.

318. See Bittker, *Taxation and the Family*, *supra* note 2, at 1411-12.

319. See Revenue Act of 1948. See also Surrey, *supra* note 314, at 1103-06.

320. See Note, *Epilogue to the Community Property Scramble: Problems of Repeal*, 50 COLUM. L. REV. 332, 332-33 (1950). See also, e.g., Bittker, *Taxation and the Family*, *supra* note 2, at 1414 (describing the repeal of community property statutes in the wake of the Revenue Act of 1948).

321. See generally Cunningham & Schenk, *supra* note 14, at 727.

indicated that many tax consequences should flow from “ownership,” but, aside from the rules for bonds with attached coupons,<sup>322</sup> Congress has not defined ownership.<sup>323</sup> Thus, while it is not necessary for community property to be congruent with the appropriate scope of income-splitting, it is conceivable that it could. I return to this question in Part V.

Finally, whatever the policy that motivates the chosen scope of income-splitting may be, that policy must be clarified because it potentially competes with an important policy of the income tax: progressivity. If we view a higher-income spouse as in fact sharing less than half the increment of her income over that of the lower-income spouse, then the *Earl* case protected progressivity by preventing a lowering of rates that did not correspond to a true shift of income. Mr. Earl assigned half his income to his wife by contract, but there is little assurance that this reflects genuine sharing.

Interestingly, the Earls’ arrangement has received some measure of approval from recent commentators who seem to take the assignment at face value.<sup>324</sup> Because there is no mechanism to enforce true sharing that would deserve a splitting-induced lowering of the spouses’ rates, this judgment is too hasty. Not much prevents couples from making an *Earl*-like assignment subject to a side-deal that whatever amount of the income is saved will be transferred back to the earning spouse as a “gift” after a year or two. There is, of course, the risk that a divorce will occur in the meantime, but the problem here is that there will be what I have called “tax-shelter” opportunities. For example, the earning spouse may make an “assignment” in which the other spouse agrees to transfer back a substantial amount of this “shared” amount. Actually, sharing is only occurring to the extent of the tax-shelter fee or kickback, but if we take *Earl*-style arrangements at face value, then such opportunities immediately arise. Po-

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322. See I.R.C. § 1286 (1994).

323. See Cunningham & Schenk, *supra* note 14, at 727. Noël Cunningham and Deborah Schenk go on to advocate extending the § 1286 approach to defining ownership under the Code generally. See *id.*

324. Bittker expressed this opinion over 20 years ago:

Mr. and Mrs. Earl were prophets without honor in another respect. By establishing for themselves a marital regime of equal ownership and equal control of their joint income in 1901, they foreshadowed an idea that contemporary women’s rights advocates often present as novel, and that many regard as worthy of being imposed by law on all married couples. Moreover, it was only by equalizing their financial positions that they put themselves in a position to claim the tax advantage of equal-income separate returns.

Bittker, *Taxation and the Family*, *supra* note 2, at 1402. See also, e.g., Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 378 (favoring retaining the *Earl* approach of taxing earned income to the earner); Gann, *supra* note 2, at 60-61 (discussing the effects of overriding *Earl* and extending the possibility of income-splitting to states with common-law systems of property distribution).

licing these arrangements may be difficult, as is recognized in the nearly-identical area of interspousal “transfers” of property that are designed merely to transfer tax liability to a lower-bracket spouse under individual filing.<sup>325</sup> Intermediate filing eliminates this incentive altogether, and it prevents temporary assignments. The assignment under intermediate filing *must* be used on divorce, and changes in the ratio can be either prohibited or made subject to the cooling-off periods and recapture rules suggested earlier.<sup>326</sup>

Thus, modern commentators’ sympathy for the Earls is premature, because an assignment like the one the Earls’ made still gives too little assurance of actual sharing. As I will argue at greater length in Part V, the same criticism can be leveled at the actual result in *Seaborn*: Community property, despite popular myth to the contrary, does not enforce sharing in marriages or on divorce to nearly the extent that it may appear. The history of marital taxation in the United States reflects a failure to come to grips with the problem of marital ownership. Neither *Earl* nor *Seaborn* addressed the important and interrelated issues of how to define ownership under the Code and how to make sure that such a definition of ownership really reflects—ideally by *enforcing*—marital sharing.

## V. OTHER NONTRADITIONAL APPROACHES TO FILING

Both *Earl* and *Seaborn* failed in the end to define ownership or ensure that income-splitting for tax purposes would reflect sharing. Community property, however, sounds as if it mandates sharing: Marital property that belongs to the community is under the equal control of each spouse and is shared equally on divorce. However, community property is quite deceptive in this respect: Even community property does surprisingly little to enforce the degree of sharing that full income-splitting would imply. That even community property falls short in this regard is a powerful argument favoring intermediate filing.

### A. COMMUNITY PROPERTY AS A POSSIBLE INDEX FOR MARITAL SHARING

Because neither individual filing nor the full income-splitting of joint filing necessarily captures the standard-of-living or the ability-to-pay tax of the individual marriage partners, we might ask whether the *Seaborn* Court stumbled on a good compromise: Should marital income-splitting be allowed but only to the extent of community property? The question of

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325. See *supra* Part III.F.

326. See *supra* Part III.B.

whether community property is normatively a good basis for determining who to tax is complicated by the very factor that motivated the Court in *Seaborn*: Despite some consensus that marriage can and should affect utility through sharing, not everyone agrees which, if any, benefits from marriage ought to be taxed. However, this section asks whether community property corresponds with *anyone's* normative view.

Before turning to this question, it is necessary to ask what we mean by "community property," because community-property regimes have been and still are characterized by a great deal of diversity. California's notable system retained common-law property features until 1973.<sup>327</sup> More importantly, not all community-property states require equal division of community property on divorce; California, Louisiana, New Mexico, and Puerto Rico maintain such a requirement, but Arizona, Idaho, Nevada, Texas, and Washington allow courts to engage in equitable distribution with substantial judicial discretion.<sup>328</sup> On the other hand, modern community property statutes, unlike the one in *Seaborn*, do not give the husband special management and disposition rights but rather give both spouses those rights.<sup>329</sup>

The Court in *Seaborn* did not face some of these complications for two reasons. First, the case itself presented the system of only one state—Washington. More importantly, the Seaborns' financial situation was very simple: Neither of the Seaborns had separate property. Thus, the community-property regime had a pure income-splitting effect in that case. But in holding that state community property laws should be used to determine taxable ownership, the Court did not limit itself to the special situation of a couple with no separate property. In *Harmon*, the Court simply dismissed without explanation the impact of some crucial complicating features, antenuptial agreements, transmutation, and separate property on its conclusion in *Seaborn*.<sup>330</sup> However, these features seriously undermine the value of community property as a possible basis for income-splitting in taxation. Again, we need more assurance of actual sharing than community property provides.

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327. See Susan Westerberg Prager, *The Persistence of Separate Property Concepts in California's Community Property System, 1849-1975*, 24 UCLA L. REV. 1 (1976).

328. See W.S. McCLANAHAN, COMMUNITY PROPERTY LAW IN THE UNITED STATES §§ 12:5-12:14, at 531-46 (1982).

329. See, e.g., CAL. FAM. CODE § 1100(a) (West 1994).

330. See *Commissioner v. Harmon*, 323 U.S. 44, 48 (1944).

### 1. *Separate Property*

Income-splitting does not extend to “separate property.” In a community-property system, not all property held by the spouses is community property. Rather, community property is that property held by the spouses with equal present interests, and all property acquired during the marriage is community property unless some exception is made.<sup>331</sup> Exceptions render property “separate” property, and states vary in the extent of such separate property. For example, in California the major categories of separate property are as follows: “(1) [a]ll property owned by the person before marriage[,] (2) [a]ll property acquired by the person after marriage by gift, bequest, devise, or descent[, and] (3) [t]he rents, issues, and profits of the property described in this section.”<sup>332</sup> A few states follow the original Spanish system in making the third category, the return on separate property, count as community property.<sup>333</sup>

Even if separate and community property were immutable categories, it is unlikely that these divisions correspond to the benefits and burdens of marriage. As far as the primary earner or the spouse with greater assets is concerned, community property may overestimate or underestimate the “burden” on the primary-contributor spouse. If the wealthier spouse has legal or even de facto control during the marriage,<sup>334</sup> that spouse may derive a greater ability to pay or a higher standard of living from the community assets than the secondary spouse, who may derive less benefit than he would on paper. On the other hand, the wealthier spouse may choose not to exercise control and may instead commingle the separate property such that it is separate in name alone and on divorce would be counted as community property because of this commingling.<sup>335</sup> In terms of the analytical framework based on donative transfers, such a spouse could in effect make a transfer without a change in the legal label from “separate” to “community.” This problem of underestimating sharing and overtaxing the better-off spouse is less serious than the overestimation problem just noted, however, because the couple can change the status of property by agree-

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331. See, e.g., CAL. FAM. CODE § 760 (West 1994) (“Except as otherwise provided by statute, all property, real or personal, wherever situated, acquired by a married person during the marriage while domiciled in this state is community property.”).

332. *Id.* § 770.

333. See MCCLANAHAN, *supra* note 328, § 4:10.

334. See *supra* Parts II.A.2 and IV.A.

335. In California, if a spouse commingles separate with community funds, the presumption is that property purchased with commingled funds is community property, and the spouse claiming a separate property interest has the burden of tracing, which may be hard to meet. See, e.g., *See v. See*, 415 P.2d 776 (Cal. 1966).

ment.<sup>336</sup> The underestimation problem exists for those not aware or sophisticated enough to make such an arrangement. Quite unfairly, those who are not sophisticated enough to take advantage of the opportunity to manipulate labels will be subject to higher tax.

Furthermore, after *Blair*,<sup>337</sup> income from property (as opposed to income from services) is relatively easy to shift. Thus, it is possible for one spouse to keep separate property and shift the income to the other spouse by using trusts.<sup>338</sup> Moreover, side-deals are possible as long as one is willing to undergo the risk of property loss on divorce in the meantime. This is not directly the fault of the community-property system, but as long as *Blair* allows shifting of income from property, calling something “separate property” does not ensure it will be taxed that way.

Finally, the issue in both *Seaborn* and *Earl* was whether to allow splitting of the primary earner’s earned income. This income is a return on human capital, and it is not obvious that allowing splitting really does measure income or well-being accurately. If, as is common now, community property does not include the value of the primary earner’s human capital, it becomes much more doubtful that the secondary earner is enjoying that degree of control, even during the marriage, that would lead us to conclude that taxing to the secondary earner rather than to the primary earner is appropriate.

## 2. Transmutation

The freedom to shift income from property is not the only freedom allowed under community-property regimes. In community-property states, spouses can “transmute” property. In California, spouses can transmute property from community property to separate property of either spouse, from separate property of either spouse to community property, or from separate property of one spouse to separate property of the other spouse.<sup>339</sup> This means that the spouses can move property around to gain maximum advantage from income-splitting and can then transmute it

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336. See *infra* Parts V.A.2 and V.A.3.

337. 300 U.S. 5 (1937). See *supra* notes 293-96 and accompanying text.

338. Because current law generally makes joint filing the only realistic choice for most couples by applying unfavorable rates to those married persons filing separately, see I.R.C. § 1(a), (d) (West Supp. 1998), there is little reason to use trusts for income-splitting purposes. See *supra* note 9. Although the Code does contain elaborate rules on the taxation of the grantor versus the beneficiary, the question remains whether a trust, for example, that provided for a reversionary interest in the grantor spouse on a divorce initiated by the beneficiary spouse would count as a grantor trust, taxable to the grantor spouse under § 671 and § 673. See I.R.C. §§ 671, 673 (1994).

339. See CAL. FAM. CODE § 850 (West 1994).

back.<sup>340</sup> If the less wealthy spouse can be influenced or pressured by a stronger spouse,<sup>341</sup> the opportunity to transmute property in either direction affords an income-splitting device at least as, if not more, flexible than the arrangement that the Earls attempted to use. The tax-shelter opportunity from the false appearance of sharing is present even under community property.

### 3. Antenuptial Agreements

Similarly, a couple may alter their rights before marriage. Recall that commentators in the 1940s were well aware that the main difference between the optional Oklahoma community-property system in *Harmon* and most previous community-property regimes was highly superficial. Income-splitting through the designation "community property" was the default in the older systems with an opt-out, but in Oklahoma a common-law system was the default with an opt-in for community property. Under *Seaborn* and *Harmon*, the tax consequences turned on the distinction between opting out and opting in.

In California, the Family Code provides that "[t]he property rights of husband and wife prescribed by statute may be altered by a premarital agreement or other marital property agreement."<sup>342</sup> The only limit on this freedom is that the parties may not alter any support obligations mandated by law.<sup>343</sup> The California Supreme Court has ruled that an antenuptial agreement providing that earnings and other property acquired during marriage will remain separate property will bind the parties even if they do not contemplate lifelong marriage.<sup>344</sup> Other states also give considerable force to antenuptial agreements.<sup>345</sup>

## B. OTHER DIVORCE AND PROPERTY LAW

If community property, which is thought to be among the stronger protections for secondary earners, fails as an appropriate basis for income-

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340. After 1984, a California statutory provision has required both spouses to agree expressly in writing. *See id.* § 852. *See also* Estate of MacDonald, 794 P.2d 911, 915-22 (Cal. 1990) (giving substance to "express declaration" and writing requirements, and noting problems with previous easy oral transmutation provisions).

341. Provisions against undue influence are not a perfect guarantee against this situation, particularly when one spouse is not aware of her rights at the time of the transmutation.

342. CAL. FAM. CODE § 1500.

343. *See* Marriage of Dawley, 551 P.2d 323, 329 (Cal. 1976) (in bank); *In re Higgason*, 516 P.2d 289, 295 (Cal. 1973) (in bank).

344. *See* Marriage of Dawley, 551 P.2d at 328-30.

345. *See* McCLANAHAN, *supra* note 328, §§ 8:1-8:11.

splitting, it is not likely that other family-law and property-law categories will do better. In this section, I tie together some observations made earlier that confirm this proposition.

The least adequate approach would be to allow income-splitting in proportion to the minimum legal support obligation that the better-off spouse bears towards the less well-off spouse.<sup>346</sup> Such an approach would share the inadequacy of all of the traditional approaches to alimony.<sup>347</sup> Furthermore, those who share *more* than the legal minimum do not get any extra benefit. Because there is no marginal decrease in tax for the primary earner from sharing, such a system offers no additional incentive to share beyond the legal minimum.

If we allowed splitting to the extent of equitable distribution on divorce, we would face many problems, the solution to which would involve a move towards intermediate filing. Using existing equitable-distribution principles would face the usual criticisms of inadequate protection of secondary earners. We would have to solve the problems of separate property, antenuptial agreements, and human capital. Furthermore, because equitable distribution is inherently discretionary and *ex post*, it is hard to predict exactly how it would be done.<sup>348</sup> For this reason, it would furnish neither the clear answers nor the information-forcing effect that, I argue, are among the principal advantages of intermediate filing. Also, if we responded to these problems in using equitable-distribution principles by asking couples to commit in advance to a ratio for division on divorce, we are well on our way to the intermediate-filing system advocated here. Intermediate filing would be the reverse of taxing according to a prediction of the division on divorce—by equitable distribution or otherwise: Intermediate filing settles such questions *ex ante* for both tax and divorce law purposes.

Finally, some have proposed that we allow couples to choose their filing status.<sup>349</sup> For example, couples would be allowed a choice of using

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346. For an acknowledgment of this possibility, see Bittker, *Taxation and the Family*, *supra* note 2, at 1422. See also Boris I. Bittker, A "Comprehensive Tax Base" as a Goal of Income Tax Reform, 80 HARV. L. REV. 925, 976 (1967).

347. See Baker, *supra* note 38, at 1206-13 (criticizing the state of alimony law).

348. This applies equally to the "contractarian" or hypothetical-bargain approach to family law as well. See *supra* Part II.B.2. Notice that such an approach to family law and one based on intermediate filing are contractarian in very different senses.

349. At some times in the past, the Code has contained a secondary-earner deduction. Most recently, a secondary-earner deduction was abolished in 1986. See CONGRESSIONAL BUDGET OFFICE, *supra* note 10, at 51-53. Such a deduction would lower rates for secondary earners and is compatible with intermediate filing.

current joint filing or individual filing. Such a solution would be expensive in terms of revenue loss in that all the marriage “bonuses” in the present system would be maintained by tax-minimizing couples.<sup>350</sup> Couples would have an incentive to overreport sharing; they would split income for tax purposes without regard to how much sharing was occurring. Without the countervailing incentive of the self-assessed ratio under intermediate filing, couples would choose the maximum split and the primary earner and/or wealthier spouse would again have no incentive to share in fact. Moreover, such a system would do nothing to prevent tax avoidance on property income.

## VI. A THEORY OF SHARING IN THE ATTRIBUTION OF INCOME

In this section, I address how the system based on self-assessed ratios could be generalized to other groups of taxpayers who share joint economic interests and who could argue for some consolidation of their income for tax purposes. This problem of choosing among taxpayers for purposes of attributing taxable income is quite general and one of the thorniest that tax policy has to offer. By defining the group members’ ownership interests in important respects, the self-assessed intermediate-filing system can solve similar difficulties in measuring sharing that stem from a tax-driven desire to overstate the sharing within the group. With this more general analysis in hand, we also can discern the limits of self-assessment: Because self-assessment crucially rests on a contractarian notion of consent, we may see which contexts—most notably with respect to parents and minor children—in which we might not want to allow self-assessment.

Until now, we have focused on the taxation of married couples, but the problem we have been addressing and my proposed solution can both be generalized. At issue in the marital tax context is when it is appropriate to regard one taxpayer as a “conduit” of income to the other, such that the second recipient taxpayer ought to pay the tax rather than the “conduit” taxpayer. In the case of spouses, there may be a net transfer of monetary resources from one spouse to the other, and, as seen above, it makes sense both from an equity and efficiency perspective to tax the recipient—but only so long as sharing by the conduit taxpayer can really be said to occur.

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350. See, e.g., Marriage Tax Elimination Act, H.R. 2456, 105th Cong. (1997) (proposing legislation that would implement a traditional solution of allowing married couples a choice of filing jointly or separately). See also CONGRESSIONAL BUDGET OFFICE, *supra* note 10, at 55-56 (noting the large loss of revenue that would result from allowing couples to choose between current joint filing and individual filing).

Under the self-assessed system, the amount declared as shared, transferred by the conduit, for income tax purposes is then backed up with a corresponding property-law and family-law rule of division. Thus, a conduit for tax purposes is a true conduit because the property interest of the other spouse is *defined* in terms of the prenegotiated tax-conduit (sharing) ratio.

In these terms, the problem can be seen as one facet of a larger problem. There are many social relations in which multiple taxpayers seem to have joint economic interests and some transfer of income from one to the other occurs. Examples of these include parent(s) and children, extended families, cohabiting couples, communes, and any other cooperative living arrangement. As is well known, it would be difficult to investigate the nature of each of these varied arrangements and allow income-splitting—taxation of some income to the transferee rather than to the “conduit”—to the extent that the arrangement really does represent a joint economic enterprise.<sup>351</sup> Indeed, even the question of what is a “family” receives a very wide range of responses.<sup>352</sup> If we simply took people’s word on such matters, people would have an incentive to overreport the amount of sharing in such groups in order to lower overall taxes. Lower-bracket taxpayers could sell their participation for some fee up to the savings in tax liability. This is the general version of the “tax-shelter” opportunity in the marital context.<sup>353</sup> There would be little to stop a group from declaring itself such a joint economic enterprise to a greater extent than resources were really being transferred, simply in order for high-bracket taxpayers in the group to lower their taxes. If we simply allowed joint filing for such groups, we face both the question of where to stop, as well as the problem that any such rule will be over- and underinclusive. A search among existing legal categories—such as parent-child, niece-aunt, and grandchild-grandparent—inevitably faces these difficulties. But traditionally, the question of when to allow splitting has consisted of just such a search among existing legal categories for determinants of consolidation for tax purposes.<sup>354</sup>

Self-assessment here too provides a possible approach to this seemingly insoluble problem. Under self-assessment, we can ensure that the

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351. See, e.g., Bittker, *Taxation and the Family*, *supra* note 2, at 1398-99.

352. See Kornhauser, *Love, Money, and the IRS*, *supra* note 2, at 65-73. See also *id.* at 69 (noting that many researchers use the notion of *commitment* to define families). Intermediate filing is well-suited to putting commitment to the test.

353. See *supra* notes 151-54 and accompanying text.

354. See, e.g., Bittker, *Taxation and the Family*, *supra* note 2, at 1399. See also, e.g., McIntyre & Oldman, *supra* note 2, at 1578 (“In answering [the question of who the taxpayer is], current law looks principally at property rules”).

extent of negotiated consolidation for tax purposes will dictate important aspects of ownership. We can set up a system whereby such groups of taxpayers must, if they separate, divide their property in accordance with the same ratio they declared for income-splitting purposes on their tax returns. As in the marital context, the group has countervailing incentives to report a more even ratio for income tax and report a less even, less sharing ratio in light of the possible use of such a ratio on break-up of the group. We do not face the usual problem of the tax rule not reflecting true ownership because, once again, the tax income-splitting ratio defines ownership to a large extent.

Nor is self-assessment likely to lead to an explosion of taxpayers opting into such a system. Tax theorists have been quite aware that transfers of income face greater or lesser risk of "ingratitude" on the part of the transferee, which inhibits use of such transfers to effect tax avoidance. There is always a risk that the tax-motivated transfer will result in the transferee taking the money and running.<sup>355</sup> Transfers range from those to spouses at the most secure end of the spectrum, running through various transfers to children and other close relatives, to those to other third parties where the risk of ingratitude is greatest. This realization itself suggests that few, besides spouses and some others with closely related dependents would opt into a more generalized, self-assessed income-splitting arrangement. The risk of ingratitude is precisely what the conduit must beware of when he attempts to lower his income tax bill through a prenegotiated income-splitting ratio. Again, the incentive to lower taxes through a move towards more even splitting of income is counterbalanced by the incentive not to put one's assets at too great a risk of being lost on break-up. The fear of ingratitude magnifies the countervailing incentive that pushes such taxpayers away from income-splitting. This view is supported by recent work on bequests showing that people give *less* in gifts than tax-avoidance would dictate.<sup>356</sup> Again, under intermediate filing, there should be little incentive to overstate the amount of integration of economic interests and sharing actually occurring.

Because self-assessed intermediate filing rests on the potential to contract around a default, it works best where such an expectation is realistic. By the same token, intermediate filing cannot be easily extended to

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355. See, e.g., Bittker, *Taxation and the Family*, *supra* note 2, at 1441 & n.141. But see Feldstein & Feenberg *supra* note 4, at 69 (arguing that people would not shift property around because of the high chance of divorce). Feldstein and Feenberg are overly optimistic about this, as I argue in Parts III.B-E and V *supra*.

356. See JAMES POTERBA, THE ESTATE TAX AND AFTER-TAX INVESTMENT RETURNS 24-25 (National Bureau of Econ. Research Working Paper No. 6337, 1997).

minor children. While we might, if we so chose, allow adult relatives to split income as long as they commit to it over the long term, this will not work with minor children. We cannot expect them to bargain or to give their consent.<sup>357</sup>

What intermediate filing might do is help with the question of how to allocate deductions relating to children. Although there is disagreement over how much the allocation of deductions to the mother versus the father really results in behavioral and welfare effects within the family,<sup>358</sup> we may ask whether self-assessment might help here, too. The most straightforward solution would be to allocate child-related deductions according to the same ratio as the couple negotiates. For default individual filers, we might allocate all the deduction to the secondary earner or split the deduction in a number of other ways.<sup>359</sup> On the other hand, if we wish to treat child responsibilities as a separate category, as suggested by current family law, we could allocate child-related deductions to the secondary earner as a default and make couples opting into intermediate filing negotiate a ratio for the child-related deductions. This ratio would be used as a floor for child support payments after divorce.

As should be clear by now, there are no technocratic “solutions” in this area, but intermediate filing both allows us to build a strong role for sharing into the tax system and helps us to refine our intuitions about the importance of sharing. In this way, intermediate filing can have an information-forcing effect on the policy level as well. If we would not accept intermediate filing for a given group of taxpayers who genuinely do seem to share income, this strongly suggests that some other value trumps sharing. For example, if society considers some groups to be “cults,” intermediate filing would not be acceptable regardless of the extent of sharing. Further, where society has no such objection to the group of taxpayers, a lack of acceptance for intermediate filing might suggest that we fear that sharing is not going on. Thus, in marriage, if someone wishes to promote marriage in general, favors sharing, but opposes intermediate filing, the problem may well be a belief that intermediate filing exposes *as empty* the commonly expressed strong rhetoric in favor of sharing. Just as interme-

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357. See generally E. ALLAN FARNSWORTH, *CONTRACTS* § 4.4 (2d ed. 1990).

358. Compare Alstott, *supra* note 28, at 2049-50 (arguing that allocating allowances may not increase women's after-tax income if husband controls money) with Kornhauser, *Partnership Model*, *supra* note 75, at 1445 n.68 (noting that studies that suggest that when women have their own money they have more control). See also Lundberg et al., *supra* note 58; *supra* notes 61, 176, and accompanying text.

359. See, e.g., Bittker, *Taxation and the Family*, *supra* note 2, at 1444-56 (discussing problems involved with dependency exemptions).

diating filing would force the primary earner to support professions of willingness to share with enforceable guarantees, so intermediate filing can put our general confidence in marital and other sharing to the test.

Intermediate filing should not be thought of as an attempt to escape the need to base the choice of taxpayer or attribution of income on society's shared values. Boris Bittker is correct that we cannot decide between individual and joint filing from some neutral standpoint but will rather have to consider "society's assumptions about the role of marriage and the family," and the decision "in the end can rest on nothing more precise or permanent than collective social preferences."<sup>360</sup> But intermediate filing does expand the *range* of choices and the amount of relevant information. We can escape the "battle of the neutralities" of the joint-versus-individual-filing debate by providing a system more narrowly tailored to the values, sharing in particular, that we want to promote. In addition, intermediate filing has efficiency advantages that flow directly from this fine-grained nature. As the question of how far to extend the option of intermediate filing to other groups indicates, we still must ask ourselves what the consequences are in terms of the values we wish to promote. But intermediate filing allows us to make that question both more precise and open to a wider range of answers.

## VII. CONCLUSION

This Article has explored the implications of intermediate filing. As I have shown, it is a sensible method of implementing in the income tax our commitment to sharing in marriages. By combining features of individual and joint filing, it presents a range of equity and efficiency benefits that neither of these two polar systems has to offer. Intermediate filing's voluntary nature and contractarian basis lead to information-forcing and optimal damages on divorce, which should induce more efficient behavior and make women better off. More generally, moving the analysis beyond the traditional polar "solutions" to the trilemma of choosing between progressive rates, marriage neutrality, and couples neutrality allows us a window on the role that sharing plays in our intuitions about marital taxation. This thought experiment based on intermediate filing extends naturally to other groups of taxpayers. By considering the possibility and likely (un)acceptability of intermediate filing in the context of other social relations, we can isolate the role that sharing is or is not playing in our atti-

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360. *Id.* at 1392, 1463. See also GRAETZ, *supra* note 2, at 39-40; Zelenak, *Marriage and the Income Tax*, *supra* note 2, at 342 (concurring in this view).

tudes toward the taxation and attribution of income within such social groups. In the particular context of marriage that has been our main focus and that is the most pressing such issue in tax policy today, intermediate filing deserves serious consideration, which is likely to increase understanding of our attitudes toward sharing in marriage.