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WHICH TAX UNIT FOR THE FEDERAL INCOME TAX?

*Frederick R. Schneider**

I. Introduction

The federal income tax statute allows a married couple to file a joint return,[1] thus treating the couple as a single economic unit. Federal law also allows a husband and wife to elect to file separate returns,[2] in effect allowing the couple to treat themselves as separate economic units. Since the beginning of federal income taxation, the principal tax unit has been the individual. Joint returns with a separate rate schedule have only been authorized for married couples since 1948.[3] From time to time, discussion has arisen about whether married couples should be permitted to file jointly or should be required to file separately.[4] In recent years, there has been a resurgence in the joint versus separate filing discussion.[5] The issue of whether the family or family members ought to be the tax unit has also been occasionally discussed.[6] This article considers the individual, married couples, and the family as three possible tax filing units. This article also evaluates the possibility of using households as a tax unit for the personal income tax.

During the past several years, a number of changes have prompted further examination of this subject. Today, people are living together in an increasing variety of relationships. Over the years, the population of

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1. I.R.C. § 1(d) (1988).
2. *Id.*
3. *See infra* notes 41-42 and accompanying text.
4. Much of the discussion is summarized in Daniel J. Lathrope, *State-Defined Marital Status: Its Future As An Operative Tax Factor*, 17 U. C. Davis L. Rev. 257 (1983). *See also* Jeanette Anderson Winn & Marshall Winn, *Till Death Do We Split: Married Couples and Single Persons Under The Individual Income Tax*, 34 S.C. L. Rev. 829 (1983).
5. *See, e.g.*, Laura Ann Davis, Note, *A Feminist Justification For The Adoption Of An Individual Filing System*, 62 S. Cal. L. Rev. 197 (1988); Marjorie E. Kornhauser, *Love, Money, and the IRS: Family, Income-Sharing, and the Joint Income Tax Return*, 45 Hastings L. J. 63 (1993); Lawrence Zelenak, *Marriage and the Income Tax*, 67 S. Cal. L. Rev. 339 (1994).
6. The discussion began many years before 1948. *See e.g.*, Stanley S. Surrey, *Family Income and Federal Taxation*, 24 Taxes 980 (1946); Harold M. Groves, Federal Tax Treatment of the Family (1963); William A. Klein, *Familial Relationships and Economic Well-Being: The Family Unit Rules for a Negative Income Tax*, 8 Harv. J. on Legis. 361 (1971).

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the United States has grown significantly.[7] The demographics of the American population have changed significantly. An increasing number and percentage of the population are presently at least sixty-five years of age.[8] The number of marriages per year grew from 1,523,000 in 1960 to 2,407,000 in 1986.[9] In the same period of time, however, the number of divorces and annulments per year skyrocketed from 393,000 in 1960 to 1,178,000 in 1986.[10] Since 1986, the rate of divorces and annulments has dropped slightly.[11] Consequently, since 1986 the number of families and households has increased significantly,[12] while the number of non-family households has more than tripled.[13]

In addition, the number of unmarried couples more than quadrupled in less than twenty years, from 523,000 in 1970 to 2,588,000 in 1988.[14] While it is difficult to obtain accurate figures, it is general knowledge that the number of same-sex couples has increased dramatically. The Statistical Abstract does not report figures for same-sex couples.[15] The 1994 Information Please Almanac states: "The number of cohabitating couples doubled between 1960 and 1977 from fewer than 500,000 to almost 1 million and grew rapidly from that time."[16] Accurate figures for the number of same-sex couples have not always

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7. There were 152,271,000 people in the United States in 1950; 180,671,000 in 1960; 205,052,000 in 1970; 227,757,000 in 1980; and 255,462,000 in 1992. BUREAU OF THE CENSUS, U.S. DEPT. OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 8 (1993) [hereinafter 1993 ABSTRACT].

8. In 1960, there were 16,675,000 persons aged 65 and older; they comprised 10.95% of the population. BUREAU OF THE CENSUS, U.S. DEPT. OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 37 (1990) [hereinafter 1990 ABSTRACT]. By 1991, there were 31,754,000 people aged 65 and older comprising 15.5% of the population. 1993 ABSTRACT, *supra* note 7, at 15.

9. 1990 ABSTRACT, *supra* note 8, at 86.

10. 1990 ABSTRACT, *supra* note 8, at 86.

11. In 1991, there were 1,187,000 divorces and annulments. 1993 ABSTRACT, *supra* note 7, at 73.

12. A family household consists of at least one parent and at least one dependent. A non-family household consists of a single adult with no dependents. There were 52,799,000 households in 1960 and 92,830,000 in 1989. There were 44,905,000 family households in 1960 and 65,837,000 in 1989. Of the family households, there were 1,275,000 male heads of households in 1960 and 2,847,000 in 1989; the number of female heads of households increased from 4,507,000 in 1960 to 10,890,000 in 1989. BUREAU OF THE CENSUS, U.S. DEPT. OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 46 (1992) [hereinafter 1992 ABSTRACT]. By 1992, the number of households increased to 95,668,000. The number of male heads of households had increased to 3,625,000 by 1992 and the number of female heads of households had increased to 11,692,000 in the same time period. 1993 ABSTRACT, *supra* note 7, at 55.

13. There were 7,895,000 non-family households in 1960, but 28,496,000 in 1992. 1993 ABSTRACT, *supra* note 7, at 55.

14. 1990 ABSTRACT, *supra* note 8, at 44.

15. A search of the tables of the 1993 ABSTRACT, *supra* note 7, found no such information. Searches of other editions of the Statistical Abstract likewise produced no information.

16. 1994 INFORMATION PLEASE ALMANAC 450.

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been easy to find.[17] Further, same-sex couples will be able to marry, at least in a few jurisdictions. The Supreme Court of Hawaii, for instance, has ruled that state laws that prohibit same-sex couples from marrying violate the equal protection provisions of the Hawaii Constitution.[18]

In addition to these changes in household composition, the Tax Reform Act of 1986[19] significantly changed the tax rules that allocated and attributed income and exemptions among taxpayers. Some of the changes could be construed as moving toward the use of the family as a tax unit.[20] These factors suggest that it would be worthwhile to reconsider the constitution of the appropriate tax unit for the personal income tax.

For a clearer understanding of the issues in this article, Section II provides a brief history of the personal income tax, including income shifting and attribution of income.[21] Section III examines basic economic theory and common law rules relevant to income tax.[22] Section IV discusses the possible tax units.[23] Section V concludes by recommending the household as the proper tax unit.[24]

II. Brief Tax History

A. *Single Persons and Married Couples*

The present personal income tax is a direct descendant of the income tax adopted by Congress in 1913.[25] Since that time, the personal

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17. Professor Clark suggests reasons for the inaccurate knowledge.

> It is difficult to determine just how large a proportion of the general population may accurately be characterized as homosexual, for two reasons. The first is that since there is still a social stigma, accompanied by material or financial or legal penalties, attached to being a homosexual, many homosexuals naturally choose to conceal, or not to reveal, their identities. The second reason is that a precise definition of homosexuals has never been formulated . . . .

Homer H. Clark, The Law of Domestic Relations in the United States 75 (2d ed. 1988).

18. Baehr v. Lewin, 852 P.2d 44 (Haw. 1993).

19. 100 Stat. 2085.

20. Included in the changes made by the Tax Reform Act of 1986 were the creation of the "Kiddie Tax" and the elimination of double use of the personal exemption for dependent children. See *infra* notes 96-100 and accompanying text for a discussion on the "Kiddie Tax."

21. *See infra* notes 25-141 and accompanying text.

22. *See infra* notes 142-63 and accompanying text.

23. *See infra* notes 164-305 and accompanying text.

24. *See infra* note 306 and accompanying text.

25. Tariff Act of October 3, 1913, 38 Stat. 114. The first income tax was levied to help provide revenue for the Civil War. Revenue Act of August 5, 1861, 12 Stat. 292 (expired 1872). In *Springer v. United States*, the 1861 tax was found to be a valid excise tax or duty. 102 U.S. 508 (1880). An income tax was again levied in 1894. Tariff Act of August 27, 1894, 28 Stat. 509 (1895). That tax was found to be an unconstitutional direct tax. Pollock v. Farmers Loan & Trust Co., 157 U.S. 429 (1895), *overruled by* South Carolina v. Baker, 485 U.S. 505 (1988). Ratification of the Sixteenth Amendment to the Constitution became effective on February 25, 1913, paving the way for the 1913 enactment of an income tax. The Supreme Court found that the

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income tax has not treated families or households as taxable units. Instead, since its inception, the income tax has been levied on individuals.[26] Beginning in 1948, joint filing by married couples was allowed.[27] Prior to 1948, each member of a family was required to file a separate income tax return, complete with separate exemptions and deductions, in all common law jurisdictions. In community property jurisdictions, however, state property law split the community property income between the husband and the wife. Therefore, each spouse was taxed on one-half of the property income, regardless of which spouse actually earned the income.[28] Thus, for married couples living in community property jurisdictions, their combined income was typically subject to less income tax than the same combined income of married couples living in common law jurisdictions.[29] Married couples in common law property system states could not achieve this result through a voluntary contract.[30] The appropriateness of this disparity between common law

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income tax levied by the Tariff Act of October 3, 1913 was constitutional. Brushaber v. Union Pac. R.R., 240 U.S. 1 (1916). *See also* Stanton v. Baltic Mining Co., 240 U.S. 103 (1916). The income tax was continued through various amendments and reenactments until 1939 when Congress recodified all internal revenue laws. Revenue Act of 1939, 53 Stat. 1. In 1954, Congress again recodified all internal revenue laws. Revenue Act of 1954, 68A Stat. 3. The 1954 Code is the foundation for the current tax code, although major amendments were made in 1969, 1976 and 1986. *See* Tax Reform Act of 1969, 83 Stat. 487; Tax Reform Act of 1976, 90 Stat. 1520; Tax Reform Act of 1986, 100 Stat. 2085. The Tax Reform Act of 1986 provided that the Internal Revenue Code of 1954 would thereafter be known as the Internal Revenue Code of 1986. *Id.* § 2, at 2095. The sections were generally not renumbered. *Id.* § 3(a), at 2095.

26. The Revenue Act of August 5, 1861, levied the income tax on "every person residing in the United States." Revenue Act of August 5, 1861, 12 Stat. 292, 309 (codified as I.R.C. § 49 (1861)). The 1913 Act required all persons to file their own returns. Tariff Act of October 3, 1913, 38 Stat. 114, 166 (codified as I.R.C. § IIA (1913)). Section 51 of the 1939 Code required every individual to file a return, but a husband and wife had the option of filing separately or jointly. 53 Stat. 1, 27 (1939). The Code provided only one rate schedule for individuals; there was no separate rate schedule for married persons filing jointly. *See id.* § 12, at 5. The normal effect of such a joint filing would be to increase the tax due and owing if both the husband and wife had taxable income. Professor Bittker pointed out, however, that in some circumstances the tax on the combined income might actually be reduced: "A joint return could increase a generous couple's deductions for charitable contributions . . . . Capital losses incurred by one spouse could be used to offset capital gains of the other spouse." Boris I. Bittker, *Federal Income Taxation and the Family*, 27 Stan. L. Rev. 1389, 1400 (1975). Joint returns as we know them today were not authorized until 1948. Revenue Act of 1948, 62 Stat. 110, 114-16 (codified as I.R.C. §§ 301-03 (1948)).

27. *See infra* notes 41-42 and accompanying text.

28. This result of community property laws was recognized and enforced by the Supreme Court. Poe v. Seaborn, 282 U.S. 101 (1930). *Poe* was one of four test cases filed by the Internal Revenue Service to resolve the income tax consequences of community property laws. The companion cases were Goedel v. Koch, 282 U.S. 118 (1930), Hopkins v. Bacon, 282 U.S. 122 (1930) and Bender v. Pfaff, 282 U.S. 127 (1930).

29. The effect of the community property laws was to split the income of one spouse into equal shares for each spouse. Because of the progressive tax rates at the time, twice the tax on half the income totalled less than if the tax was computed on the combined income if all of the income was reported on a single return.

30. *See* Lucas v. Earl, 281 U.S. 111 (1930).

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and community property jurisdictions has generated considerable discussion.[31]

The significance of the income tax savings resulting from the community property laws was not ignored by the state legislatures of common law jurisdictions. In 1939, the Oklahoma legislature enacted a community property law which could be elected by a husband and wife.[32] In 1943, the Oregon legislature enacted a similar law.[33] However, in *Commissioner v. Harmon*,[34] the Supreme Court ruled that such an election could not prevail over a state's otherwise prevailing mandatory common law system.[35] Following the *Harmon* decision, both the Oklahoma and Oregon community property laws were made mandatory. In addition, the legislatures of Hawaii,[36] Michigan,[37] Nebraska[38] and Pennsylvania[39] adopted community property laws. Following the creation of joint filing for married couples in the Revenue Act of 1948, all of these jurisdictions returned to common law property systems.[40]

In 1948, Congress authorized joint income tax returns for married persons, coupled with a separate rate schedule.[41] The new system approximated the income tax consequences achieved in community prop-

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31. In 1975, Professor Bittker summarized much of the earlier discussion. Bittker, *supra* note 26. The discussion has continued. *See, e.g.*, Michael J. McIntyre & Oliver Oldham, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 HARV. L. REV. 1573 (1977); Pamela B. Gann, *Abandoning Marital Status as a Factor in Allocating Tax Burdens*, 59 TEX. L. REV. 1 (1980); Toni Robinson & Mary Moers Wenig, *Marry in Haste, Repent at Tax Time: Marital Status as a Tax Determinant*, 8 VA. TAX REV. 773 (1989); Dan Subotnik, *The Marriage Tax Revisited: An Analysis of the Tax Consequences of Marriage*, 90 W. VA. L. REV. 1127 (1988).

32. *See* Nanette K. Laughrey, *Uniform Marital Property Act: A Renewed Commitment To The American Family*, 65 NEB. L. REV. 120, 129 n.48 (1986) (citing Community Property Act, ch. 62, § 1, 1939 Okla. Sess. Laws 356 (repealed 1945), reenacted by Act of May 5, 1945, tit. 32, ch. 1, 1945 Okla. Sess. Laws 118 (repealed 1949)).

33. *See id.* (citing Oregon Community Property Law of 1943, ch. 440, 1943 Or. Laws 656 (repealed 1945); reenacted by Act of July 7, 1947, ch. 525, 1947 Or. Laws 910 (repealed 1949)).

34. 323 U.S. 44 (1944).

35. *Id.*

36. *See* Laughrey, *supra* note 32 (citing Act of May 22, 1945, Act 273, 1945 Haw. Sess. Laws 312 (repealed 1949)).

37. *See* Laughrey, *supra* note 32 (citing Act of July 1, 1947, No. 317, 1947 Mich. Pub. Acts 517 (repealed 1948)).

38. *See* Laughrey, *supra* note 32 (citing Act of June 12, 1947, ch. 156, 1947 Neb. Sess. Laws 426 (repealed 1949)).

39. *See* Laughrey, *supra* note 32 (citing Act of July 7, 1947, 1947 Pa. Laws 1423). The Pennsylvania Supreme Court held this law to be unconstitutional. Wilcox v. Penn Mutual Life Ins. Co., 55 A.2d 521 (Pa. 1947). The constitutionality of the other state community property laws was never determined. Several courts avoided the question. *See, e.g.*, Miller v. Stolinski, 32 N.W.2d 199 (Neb. 1948); Harris Trust & Sav. Bank v. Burlingame, 190 P.2d 1017 (Okla. 1948).

40. All of these statutes were repealed in 1948 and 1949. *See* Laughrey, *supra* note 32.

41. Revenue Act of 1948, § 301, 62 Stat. 110 (codified as I.R.C. § 301 (1948)).

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erty jurisdictions.[42] Under these new provisions, a married couple could combine their income on a joint return. The couple's income tax would then be levied at twice the tax on one-half of their combined income, resulting in a substantial tax savings. The Internal Revenue Codes of 1954 and 1986 continued the provisions for joint filing.[43]

In 1951, Congress created a new head of household status for certain single taxpayers who supported a defined class of dependents.[44] A new rate schedule was created for this group. These rates were less than those for single taxpayers but more than those for married couples who filed joint returns.[45] As incomes grew, the disparity in the tax treatment of single persons in comparison to married persons also grew. It has been reported that "[a]t some income levels, a single person's tax liability was as much as 42.1 percent higher than that of a one-earner married couple with the same taxable income."[46] In 1969, Congress responded to this problem—the Tax Reform Act of 1969 removed the correlation between the single person tax rates and the tax rates for married couples filing joint returns.[47] The Act created a new rate schedule for single persons. The Act provided for a reduced rate schedule that would produce a tax liability for single persons that was no more than twenty percent greater than the tax liability for married couples with equal income.[48] Congress justified the ongoing rate differential by explaining that a couple incurred additional living expenses not incurred by single persons.[49]

This new rate scheme resulted in a "marriage penalty." Double-income married couples were no longer allowed to use the single person

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42. The legislative history of the Revenue Act of 1948 shows that Congress was aware of the legislative changes in the common law jurisdictions and believed that the income tax law should not cause a state to adopt a community property system for income tax reasons. S. REP. No. 1013, 80th Cong., 2d Sess. 8 (1948), *reprinted in* 1948 U.S.C.C.A.N. 1163, 1184-87.

43. Internal Revenue Code of 1954, §§ 301-03, 62 Stat. 110, 114-16. These provisions appear in the Internal Revenue Code of 1986 at the same sections.

44. Revenue Act of 1951, § 301, 65 Stat. 452, 480-83.

45. This provision created a new wrinkle in the income tax system, the so-called "divorce bonus." A divorced person who kept at least one child qualified for head of household status. The combined personal exemption for the head of the household and the personal exemption of the first dependent created a larger income tax deduction for the now single person than it would have created for a married couple similarly situated. Winn & Winn, *supra* note 4, at 834.

46. Winn & Winn, *supra* note 4, at 834 (1983).

47. Tax Reform Act of 1969, § 803, 83 Stat. 487, 678-85.

48. H.R. CONF. REP. No. 91-782, 91st Cong., 1st Sess. 2 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2392, 2444. Some argue that the 1969 tax rate changes converted our system to taxation of marital units instead of individual taxation of family members. *See, e.g.*, McIntyre & Oldham, *supra* note 31, at 1584. Actually, the Internal Revenue Code allows, but does not require, married individuals to file a joint return.

49. S. REP. No. 91-522, 91st Cong., 1st Sess. 2 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2027, 2297.

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rate schedule. Thus, if two single persons married and both earned income, their new combined tax liability would be more than their combined tax liability as single persons.[50] Since implementation of this rate structure in 1969, the percentage of double-income married couples has increased. Congress reacted to the marriage penalty in 1981. As part of the sweeping changes of the Economic Recovery Tax Act of 1981, a new Section 221 was added to the Internal Revenue Code of 1954.[51] Section 221 allowed a married couple to deduct ten percent of the "qualified earned income" of the spouse who earned the lesser amount.[52] Congress justified this deduction by stating that the marriage penalty reduced respect for the family and for the tax system.[53] This ten percent marital deduction was repealed by the Tax Reform Act of 1986.[54] Apparently, no workable system exists based on a progressive income tax that allows joint filing for married couples, while avoiding marriage penalties or bonuses.[55]

This review of tax history illustrates that the seemingly simple act of allowing married couples to file a joint income tax return using a separate rate schedule continues to create difficult policy issues. Each subsequent change in pertinent tax law has created new difficulties.

B. *Income Shifting Before 1987*

Because only individuals are tax units, but married couples may elect joint filing, married couples who had dependent children were strongly motivated to seek ways to reduce their own income tax by making their children taxpayers for part of what otherwise would be their own income. Since income is taxed to individuals, it was possible for a taxpayer to give income-producing property to another taxpayer in a manner that caused future income from that property to be taxed to the donee instead of to the donor. Utilizing a combination of pre-1981 progressive tax rates, personal exemptions, and standard or itemized deductions, the division of income between two or three persons usually resulted in a reduction of the total income tax paid. Although there were some furtive attempts to shift income with informal schemes,[56] more substantive schemes were developed which were often

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50. *Id.*

51. Economic Recovery Tax Act of 1981, § 103, 95 Stat. 172, 187.

52. Section 221 allowed a deduction of up to $3,000 of the "qualified earned income." I.R.C. § 221 (1954).

53. S. Rep. No. 97-144, 97th Cong., 1st Sess. 29 (1981), *reprinted in* 1981 U.S.C.C.A.N. 105, 136.

54. Tax Reform Act of 1986, § 131, 100 Stat. 2085, 2113.

55. *See, e.g.*, Zelenak, *supra* note 5, at 339-42.

56. *See, e.g.*, Morsman v. Commissioner, 90 F.2d 18 (8th Cir.), *cert. denied*, 302 U.S. 701 (1937); Brainard v. Commissioner, 91 F.2d 880 (7th Cir. 1937).

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very effective. Thus, income could be shifted to other taxpayers, usually related, with resultant tax savings.

Children, of course, are individuals.[57] Since 1944, children have been required to file their own income tax returns if their income meets the requisite amount.[58] The tax law had always allowed children to use their own personal exemptions and any deductions available, including the standard deduction.[59] Income itself could not be shifted,[60] but income-producing property could be given to a child. Once the transfer was complete, all of the income produced by that property would be taxed to the child.[61] The same reasoning was used to tax the minor donee, and not the custodian, on income received from property when gifts were made using the Model Gifts of Securities to Minors Act, the Uniform Gift to Minors Act, and the Uniform Transfer to Minors Act.[62]

The use of gifts contains some negative consequences. Perhaps the most important drawback is that once a gift is made, the transfer is complete. The property belongs to the donee, and the donor cannot regain possession or enjoyment of the property without a gift back from the donee or a purchase of the property. Indeed, this finality of a gift is desired. If an actual or implied retained interest existed, income produced by this property would be taxed to the donor even though it

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57. I have chosen to use children as the primary example for income shifting. Income could be shifted to other taxpayers, as well. Prior to 1948, shifting income to a spouse was a tax saving scheme in common law jurisdictions. Income could also be shifted to grandchildren or other taxpayers.

58. In 1944, Congress added § 22(m) to the Internal Revenue Code of 1939. Individual Income Tax Act of 1944, Chap. 210, § 7, 58 Stat. 231, 235. Section 22(m) provided: "Amounts received in respect of the services of a child shall be included in his gross income and not in the gross income of the parent, even though such amounts are not received by the child." *Id.* In this new section, Congress affirmatively rejected Reg. 103 § 19.51-3 (1941), which required parents to be taxed on their children's earned income if by state law the parents had a right to that income. *See* H.R. REP. NO. 1365, 78th Cong., 2nd Sess. (1944), *reprinted in* 1944 C.B. 821, 837-38. This Section became § 73(a) of the Internal Revenue Act of 1954. *Id.*

59. *See* SIDNEY KESS & BERTIL WESTLIN, ESTATE PLANNING GUIDE, 91-92 (1985).

60. *See* Lucas v. Earl, 281 U.S. 111 (1930).

61. Such gifts were subject to the gift tax. Prior to 1976, gifts of property valued at more than $3,000 to any donee in any calendar year resulted in a gift tax, if the $60,000 lifetime exclusion had been exhausted. Prior to the Tax Reform Act of 1976, the gift tax was completely separate from the estate tax, and thus the transfer was subject to a gift tax. Once the gift tax was paid, there were no further transfer tax consequences. The Tax Reform Act of 1976 linked the gift tax into the estate tax computation. Section 2001(b) of the Internal Revenue Code of 1954 was amended by the Tax Reform Act of 1976, § 2001(c)(1)(D), 96 Stat. 1520, 1850-51. The Tax Reform Act of 1976 also created a unified credit. Few taxpayers, however, want to use their unified credit for lifetime transfers. In 1981, the gift tax annual exemption was increased from $3,000 to $10,000. Economic Recovery Tax Act of 1981, § 441, 95 Stat. 172, 319-20. A donor may now give $10,000 or less to any donee during a calendar year and escape all transfer tax consequences.

62. *See, e.g.*, Rev. Rul. 56-484, 1956-2 C.B. 23; Rev. Rul. 59-357, 1959-2 C.B. 212.

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might not be actually received by the donor.[63] Further, the value of the property would be included in the donor's gross estate and would be subject to the estate tax.[64] If the gift was to a minor, however, the minor's transfer back was subject to disaffirmance upon reaching majority.[65] A guardian of the minor possesses a duty to preserve the minor's property and may not make gifts of the minor's property.[66] Thus, while gifts served many useful purposes, many parents desired other means of shifting income to their children.

In addition to gifts, other effective income-shifting techniques were available. Interest free and low interest loans were popular, and often made without legal advice. Such loans might be made in small amounts, such as to help finance the purchase of an automobile or to make the down payment on a house. Sometimes, however, these loans were made in very large amounts. *Crown v. Commissioner*[67] was perhaps the most famous case involving a large interest free loan. The interest free loans in *Crown* totalled $18 million.[68] Even so, the court of appeals held that the value of the foregone interest was not a gift.[69]

In 1984, the use of loans to shift income suffered a sudden demise. First, in *Dickman v. Commissioner*,[70] the Supreme Court held that "[t]he right to use money is plainly a valuable right, readily measurable by reference to current interest rates."[71] After *Dickman*, making an interest free loan was deemed to be a transfer of property, and therefore subject to the gift tax.

Congress immediately reacted by enacting Internal Revenue Code § 7872, which created significant income tax consequences for "below market loans."[72] While a *de minimis* exception[73] and a small loan exception[74] to section 7872 exist, "below market loans" are now taxed in a very harsh manner. The harsh tax treatment discourages people from using "below market loans" except for comparatively minor transac-

63. I.R.C. § 674 (1986).
64. I.R.C. § 2038 (1954).
65. CLARK, *supra* note 17, at 310.
66. *See* 39 C.J.S. 168, § 85 (1970). *See also In re* Wemyss, 98 Cal. Rptr. 85 (1971).
67. 585 F.2d 234 (7th Cir. 1978).
68. *Id.* at 235.
69. *Id.*
70. 465 U.S. 330 (1984).
71. *Id.* at 337.
72. Tax Reform Act of 1984, § 172, 98 Stat. 494, 699-703. The Internal Revenue Service had been unsuccessful in collecting income taxes from these transactions. *See, e.g.*, Commissioner v. Greenspan, 670 F.2d 123 (9th Cir. 1983); Dean v. Commissioner, 35 T.C. 1083 (1961). Congress was well aware of this history. H.R. REP. NO. 98-432, 98th Cong., 2d Sess., pt. 2, at 1370-79 (1984), *reprinted in* 1984 U.S.C.C.A.N. at 1017-27.
73. I.R.C. § 7872(c)(2) (1988) (excepting amounts of up to $10,000).
74. *Id.* § 7872(d) (excepting amounts of up to $100,000).

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tions.[75] Any use of "below market loans" to obtain or finance any income-producing property immediately triggers income tax consequences, essentially eliminating this scheme as an income shifting device.[76]

Another popular income-shifting scheme was the "Clifford Trust."[77] A Clifford Trust consisted of a short term grantor trust which provided, in general, for payment of the income to one or more named beneficiaries, or for accumulation of the income in the trust, for a period exceeding ten years.[78] Thereafter, upon termination of the trust, the trust corpus reverted to the grantor.[79] If the trust requirements were met, the income was taxed to the income beneficiary if it was distributed to the income beneficiary. Otherwise, the income was taxed to the trust if the income was accumulated. Thus the grantor escaped income tax on this income until the trust terminated and the corpus reverted to the grantor.[80] In addition to the use of gifts, "below market loans" and Clifford Trusts, a number of other income shifting schemes developed.[81] Standard estate planning guides included explanations of all of these techniques.[82]

The importance of income shifting in the overall scheme of personal income taxes warrants consideration. A study reported in 1980[83] examined various factors which affected individual income taxes. De-

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75. Below market loans can still be used to help finance an automobile or to provide a down payment on a house.

76. For a fuller discussion of I.R.C. § 7872, see *infra* notes 124-41 and accompanying text.

77. The "Clifford Trust" was named after the taxpayer in Helvering v. Clifford, 309 U.S. 331 (1940).

78. Other termination times could be used, such as the death of the income beneficiary.

79. The technical rules which governed these trusts were codified at I.R.C. §§ 671-77 (1954).

80. One of the more recently developed income shifting schemes was a variation on the Clifford Trust. It was called the spousal remainder trust. This was a short term trust, often as short as four or five years. It differed from the Clifford Trust in that the remainder was payable to the grantor's spouse, not to the grantor, and thus it escaped the consequences of I.R.C. §§ 671-77 (1954). The income was typically payable to one of the grantor's children, and was taxed to the child as it is distributed. *See, e.g.*, Louis A. Mezzullo, *Using Short Term Spousal Remainder Trusts To Accumulate Income and Equalize Estates*, 63 J. TAX'N 76 (1985); Derek L. Smith, *The Spousal Remainder Trust*, 123 TRS. & ESTS., Apr. 1984 at 32; G. B. Weber, Jr. *et al.*, *Income-Shifting Benefits Of A Spousal Remainder Enhanced By Developments*, 12 EST. PLAN. 22 (1985). This scheme illustrates the skill and ingenuity utilized by planners to shift income in order to avoid or reduce income taxes.

81. Kess and Westlin, for example, listed joint ownership, revocable trusts, Totten Trusts, U.S. Savings Bonds, Custodial Accounts, § 2503(c) trusts, partial interest trusts, spousal remainder trusts, irrevocable trusts, and charitable remainder trusts, and unitrusts as additional techniques for shifting income to children. Kess & Westlin, *supra* note 59, at 628-31.

82. *See, e.g.*, REGIS W. CAMPFIELD, ESTATE PLANNING AND DRAFTING 515-89 (1984); HAROLD WEINSTOCK, PLANNING AN ESTATE 145-93 (2d ed. 1982).

83. Joseph J. Minarik, *Who Doesn't Bear The Tax Burden*, in THE ECONOMICS OF TAXATION 55-68 (Aaron & Michael J. Boskin eds. 1980). Using data contained in the Brookings Foun-

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ductions constituted the most significant factor at all income levels under $1 million.[84] Income shifting was the second most significant factor affecting incomes between approximately $30,000 and $200,000.[85] For incomes in excess of $200,000, the combined effect of the alternate tax on long term capital gains and the long term capital gains exclusion became the second most significant factor.[86] The authors of the study concluded that "[i]ncome splitting reduces taxes by the largest relative amounts at moderately high income levels and less at the highest and lowest incomes."[87]

C. *The New Face of Income Shifting*

The Tax Reform Act of 1986[88] significantly changed the rules that made many of the income-shifting techniques desirable and possible.[89] The 1986 Act reduced the number of tax brackets from fourteen to two. The Act created two tax rates—fifteen percent and twenty-eight percent. The 1986 Act also created a five percent surcharge at certain income levels.[90] The rate reduction and compression reduced the incentive to shift income to other members of the family because the income shifting no longer resulted in the same level of tax savings. Indeed, under some circumstances, no tax savings would be achieved. Nonetheless, the difference between the lower tax rate of fifteen percent and the

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dation MERGE file, projected to 1977, the data reported for all taxpayers for 1976 is most instructive.

84. *Id.* at 59. Deductions included the standard and itemized deductions, together with the dividend, sick pay and moving expense exclusions. *Id.*

85. *Id.*

86. *Id.* The special treatment afforded to capital gains was eliminated in the Tax Reform Act of 1986. A revised treatment of capital gains was enacted by Congress, effective January 1, 1991. Revenue Reconciliation Act of 1990, § 11101(c), 104 Stat. 1400.

87. Minarik, *supra* note 83, at 61.

88. Tax Reform Act of 1986, 100 Stat. 2085.

89. A variety of articles discuss aspects of the Tax Reform Act of 1986 as it impacts on the topics discussed herein. *See, e.g.*, Roy M. Adams, et al., *Tax Reform 1986: Here Comes The Earthquake*, 125 TRS. & ESTS. 10 (Oct. 1986); Jonathan C. Blattmacher, *Child's Income May Be Taxed At Parent's Tax Rate*, 66 J. TAX'N 48 (1987); David R. Hodgman & John T. Hayes, *Family Income Planning: A New Ballgame*, 125 TRS. & ESTS. 36 (Dec. 1986). These topics were also treated at tax institutes. *See, e.g.*, Jerry A. Kasner, *Income Shifting and Pitfalls—After Tax Reform*, FORTY-FIFTH ANN. INST. ON FED. TAX'N, ch. 25 (1987); Howard M. Zaritsky, *The Hollow Crown? What's Left Of Grantor Trusts*, 26 HECKERLING INST. ON EST. PLAN., ch. 15 (1987).

90. The Tax Reform Act of 1986 § 101(a) amended I.R.C. § 1. Transitional rates were provided for the year 1987. Previously, the top rate had been fifty percent. In earlier years the top rate had been even higher. The five percent surcharge was designed to phase out the fifteen percent rate and personal exemptions. Once the upper limit of the surcharge was reached, its effect was to tax all taxable income, increased by the amount of personal exemptions, at twenty-eight percent. Thus, the benefits of both personal exemptions and the fifteen percent tax rate were eliminated for some taxpayers. In 1990, Congress changed the rate structure again by adding a thirty-one percent bracket. Revenue Reconciliation Act of 1990, § 11101(a), 104 Stat. 1400.

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higher tax rates of twenty-eight percent and thirty-one percent still provides an incentive for a family unit to shift income in some situations.[91]

Although the 1986 Act increased the personal and dependency exemptions,[92] double deduction of exemptions was eliminated.[93] Before this change took effect, a parent could take a child as an exemption on a parent's income tax return. In addition, the child could also take a personal exemption on the child's own income tax return. The effect of this double use of the personal exemption was to shelter the amount of the exemption from income tax twice. Currently, if the child is eligible to be taken as an exemption on a parent's income tax return, the child cannot take a personal exemption.[94] The natural and intended consequence of this change was to increase the taxable income of the child by the amount of the exemption lost by the child.[95]

In addition, the 1986 Act created a new provision which has come to be known as the "Kiddie Tax."[96] The 1986 Act provided rules to govern the tax brackets and rates for the unearned income of minor children under the age of fourteen. New rules for the child's standard deduction were also established. Presently, a child who is claimed as a dependent on a parent's income tax return may receive a reduced standard deduction,[97] or the child may itemize deductions. Unearned income which exceeds $500 above the amount of the standard deduction

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91. *See, e.g.*, HAROLD WEINSTOCK, PLANNING AN ESTATE: A GUIDEBOOK OF PRINCIPLES AND TECHNIQUES 174, 174-76 (3d ed. 1988).

92. Section 103 of the Tax Reform Act of 1986 raised the exemption amount to $1,900 for taxable years beginning in 1987, $1,950 for taxable years beginning in 1988, and $2,000 for taxable years beginning after December 31, 1988. In addition, an inflation adjustment was created for taxable years beginning after 1989. 100 Stat. 2085 (1986).

93. Section 103 of the Tax Reform Act of 1986 also amended I.R.C. § 151 to include § 151(d)(2), which reads:

> Exemption amount disallowed in the case of certain dependents. In the case of an individual with respect to whom a deduction under this section is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the exemption amount applicable to such individual for such individual's taxable year shall be zero.

Id.

94. I.R.C. § 151(d)(2) takes the exemption away from the child if the child is *allowable* as an exemption on a parent's income tax return. Thus, there is no opportunity to manipulate the tax return on which the exemption appears.

95. *See* H.R. CONF. REP. NO. 99-841, 99th Cong. 2d Sess., pt. 2, at 7 (1986), *reprinted in* 1986 U.S.C.C.A.N. 4095-98.

96. I.R.C. § 1(i) was enacted by the Tax Reform Act of 1986, § 1411, 100 Stat. 2085, 2714.

97. I.R.C. § 63(c)(5) now limits the standard deduction of a child whose personal exemption is claimed by another taxpayer to the greater of $500 or the child's earned income, not to exceed the regularly available standard deduction. This provision was added by § 102 of the Tax Reform Act of 1986.

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or itemized deduction will be taxed to the child at the parent's highest tax rate.[98] The practical result of these rules is that most children under the age of fourteen will receive a $500 standard deduction. The next $500 of the child's taxable unearned income is taxed at the fifteen percent rate. Finally, the remainder of the child's unearned taxable income is taxed at the parent's highest tax rate, which may be fifteen percent, twenty-eight percent, or thirty-one percent. Thus, only a comparatively small amount of the child's income will be taxed at a rate lower than the parent's rate, significantly reducing the incentive to shift income to a child who is less than fourteen years of age.[99] The special tax rate rules do not apply to a child's earned income. The earned income for children is taxed in the same manner as for an adult. The special tax rate rules also do not apply to a child who is fourteen years old or older. The rules which limit a standard deduction apply to all persons whose personal exemption is allowable to another taxpayer.[100]

In addition, Congress eliminated the use of most short term trusts as income-shifting devices. Prior to 1986, the use of Clifford Trusts[101] was very popular. The income of such a trust was taxed to the income beneficiary or to the trust, depending upon whether the income was distributed to the income beneficiary or was accumulated by the trust. Congress believed that this trust taxation scheme no longer represented good policy,[102] so the Tax Reform Act of 1986 amended section 673 to change these rules.[103] Under the new tax rules, the income is taxed to the settlor if: (1) the settlor has a reversionary interest in either the corpus or the income of the trust; and (2) at the beginning of the trust, the value of the reversion exceeds five percent of the value of that portion of the trust.[104] Thus, under the prior law, a typical Clifford Trust settlor would retain a reversion and the trust would exist for at least ten years, but normally not more than fifteen years. Using the ten percent tables, the value of a reversionary interest following a ten year trust is 38.5543% of the value transferred into the trust.[105] Since the

98. I.R.C. § 1(i) (1986).

99. In many instances, a parent may include a child's gross income over $1,000 on the parent's own income tax return. The parent will pay an additional tax equal to the lesser of $75 or fifteen percent of the child's income over $500. Usually the child will then not have to file a separate return. Technical and Miscellaneous Revenue Act of 1988, § 6006, 102 Stat. 3342, 3686-87, I.R.C. § 1(i)(7).

100. I.R.C. § 63(c)(5) (1986).

101. *See supra* text accompanying notes 77-82.

102. *See* H.R. CONF. REP. NO. 99-841, 99th Cong., 2d Sess., pt. 2, at 7 (1986), *reprinted in* 1986 U.S.C.C.A.N. 4851-54.

103. Tax Reform Act of 1986, § 1402, 100 Stat. 2085, 2711.

104. I.R.C. § 673(a) (1986).

105. Treas. Reg. § 25.2512-5(f), Table B (1994).

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value of the reversion is clearly greater than five percent of the corpus at the time the trust is created, the income from such a short term grantor trust will be taxed to the settlor—even though the income beneficiary will actually receive the income. In order to avoid these new rules, the settlor must create a trust which lasts longer than thirty-one and a half years.[106] It is believed that very few people are willing to create a trust as an income-shifting device without providing for the return of the reversion to the settlor in a more timely manner.[107]

The Tax Reform Act of 1986 also eliminated the use of spousal remainder trusts as an income-shifting scheme by amending section 672 of the Internal Revenue Code. Section 672 now provides that the grantor is deemed to be the owner of any interest held by the grantor's spouse, if the spouse was living with the grantor at the time the trust was created.[108] The possibility of income shifting among family members is now significantly reduced, probably to the point that it will not be a significant factor in future income tax avoidance schemes.

D. *Attribution of Income*

Contrary to the basic income tax principle that a tax is levied on an individual's own income, a small group of rules in the Internal Revenue Code attribute, and tax, income to a person who did not actually receive the income.[109] Given the strength of the theme of taxing the individual on personally received income, these rules might be viewed as curious aberrations in the tax law. Instead, each is a carefully planned exception to the general scheme.[110] To gain an added perspective for the examination of the use of family or household units as tax entities for the personal income tax, these rules are discussed below.

Inter vivos trusts can be used as income-shifting devices.[111] Various provisions in the Internal Revenue Code attempt to prevent a trust grantor from creating the trust while retaining some interest or power over the trust property. In this situation, the trust income is usually

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106. The value of a reversion to follow a 31 year trust is 5.2099% of the value transferred into the trust. *Id.* The value of a reversion to follow a 32 year trust is 4.7362% of the transferred value. *Id.* A trust would have to last approximately thirty-one and a half years to avoid the new grantor trust rules.

107. The only purpose for the creation of a Clifford Trust is to shift the income away from the grantor.

108. Tax Reform Act of 1986, § 1401, 100 Stat. 2085, 2711.

109. The Internal Revenue Code of 1986 continued the rules which had been made part of the Internal Revenue Code of 1954, and it also added several new rules.

110. *See, e.g.*, Glenn E. Coven, *The Affinity Provisions of the Internal Revenue Code: A Case Study In Nonsimplification*, 45 Tenn. L. Rev. 557 (1978).

111. Often the only objective in creating an *inter vivos* trust is to reduce the family income tax burden. *See* Marvin A. Chirelstein, Federal Income Taxation 188 (5th ed. 1988).

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shifted to a taxpayer who is an object of the grantor's bounty.[112] Under the Internal Revenue Code, if the grantor's "interest" in the trust is deemed substantial, the separate existence of the trust is ignored for income tax purposes and the trust income is taxed to the grantor even though the grantor never received the income.

The Revenue Act of 1924[113] contained two provisions which attributed income to the grantor of the trust in certain situations. The first of these provisions[114] is now embodied as Code section 676(a). As refined, section 676(a) attributes and taxes the income of the trust to the grantor if the grantor has retained a power to revest the trust corpus in himself. This is true regardless of whether the power can be exercised by the grantor or in conjunction with someone who is not a trust beneficiary.[115]

The second of these provisions[116] is now embodied in section 677(a). As refined, section 677(a) requires that the trust income be taxed to the grantor where the trust income can be either: (1) distributed to the grantor or his spouse; (2) accumulated for the benefit of the grantor or his spouse; or (3) applied to the payment of premiums of life insurance on the grantor's life, where these powers can be exercised by the grantor, a non-adverse party, or both.[117] These provisions are coordinated with the five percent reversion requirement of section 673. Furthermore, under the provisions of section 674(a), the income of a trust is taxed to the grantor if the grantor, either alone or acting with a non-adverse person, has the power to affect the beneficial enjoyment of the trust income or corpus.[118]

Section 673 was enacted in 1954.[119] While originally validating the scheme known as the Clifford Trust,[120] the statute was amended[121] to its present form in 1986. Under the prior ten year rule, it was highly

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112. Typical objects of a grantor's bounty include the grantor's spouse, children and grandchildren.

113. Revenue Act of 1924, 43 Stat. 253.

114. Revenue Act of 1924, § 219(g), 43 Stat. 253, 277.

115. This provision was found to be constitutional in Corliss v. Bowers, 281 U.S. 376 (1930).

116. Revenue Act of 1924, § 219(h), 43 Stat. 253, 277.

117. This provision was found to be constitutional in *Burnett v. Wells*, 289 U.S. 670 (1933). An adverse party is one who has an economic interest in the trust which would be adversely affected by exercise of the power.

118. A series of exceptions appears in I.R.C. § 674(b) (1988).

119. I.R.C. § 673 (1954).

120. Helvering v. Clifford, 309 U.S. 331 (1940), was the seminal case in this area. The Supreme Court held in that case that the trust income should be taxed to Clifford, the trust's grantor. A series of Regulations followed which culminated in the provisions adopted as part of the Internal Revenue Code of 1954. Under these Regulations, the income was *not* taxed to the grantor, but rather to the then beneficiary of the trust.

121. Tax Reform Act of 1986, § 1402, 100 Stat. 2085, 2711.

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likely that the trust corpus would be returned to the grantor during the grantor's lifetime. Congress was convinced that this was not a sufficient separation of the income interest from the ownership of the corpus represented by the grantor's reversion. Therefore, the law now requires an almost complete divestiture of the grantor's interests in the trust before effective income shifting occurs.[122] In addition, I.R.C. § 677(b) provides that income from a trust is taxed to the grantor to the extent that it is used for support of the grantor's dependents. I.R.C. § 678(a) provides that the income of a trust will be taxed to whomever has the sole power to vest either the trust income or corpus in himself.[123]

Income attribution is an important aspect of Section 7872 and its treatment of "below-market" interest in no-interest and low-interest loans. As discussed briefly above,[124] Congress enacted I.R.C. § 7872 in 1984.[125] Section 7872 applies to all gift loans[126] by treating the foregone interest[127] as a transfer from the lender to the borrower.[128] The foregone interest is then transferred back to the lender by the borrower, as if it were a payment of interest.[129] Indeed, I.R.C. § 7872 specifically applies to all "tax avoidance loans."[130] In the case of gift loans, the transfer and retransfer are both deemed to occur on the last day of the calendar year,[131] except for gift tax purposes.[132] Thus, the gift is deemed to be made once for the total amount of the foregone interest, but interest payments are deemed to occur each year throughout the period the loan is outstanding.[133]

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122. *See* Chirelstein, *supra* note 111, at 189.

123. The Code does contain several exceptions. *See, e.g.*, I.R.C. § 678(b)-(d) (1988).

124. *See supra* notes 72-76 and accompanying text.

125. Tax Reform Act of 1984, § 172, 98 Stat. 494, 699-703.

126. I.R.C. § 7872(c)(1)(A) (1988). Gift loans are defined as "any below-market loan where the foregoing of interest is in the nature of a gift." *Id.* § 7872(e)(3). Thus, for gift loans it makes no difference whether the loan is a demand loan or a term loan.

127. Foregone interest is the amount of interest which would have been payable on the loan at the applicable federal rate less any interest actually payable on the loan. *Id.* § 7872(e)(2).

128. This first transfer is usually deemed a gift. I.R.C. § 7872(e)(2) states that the value of the foregone interest is determined on the date of this first transfer. I.R.C. § 7872(b)(1) further provides that for gift tax purposes, the transfer occurs on the date the loan was made.

129. I.R.C. § 7872(a)(1) (1988).

130. The Code defines tax avoidance loans very broadly as "[a]ny below-market loan [one] of the principal purposes of the interest arrangements of which is the avoidance of any Federal tax." I.R.C. § 7872(c)(1)(D) (1988).

131. *Id.* § 7872(a)(2).

132. *Id.* § 7872(d)(2).

133. Separate rules apply for term loans which are not gift loans, and for other "below-market loans." I.R.C. § 7872(b) (1988). Essentially, the lender is deemed to make the first transfer, and the borrower is deemed to have received the cash value of the first transfer, on the date the loan is made. For "compensation-related loans" and "corporation-shareholder loans," this first transfer will be income to the borrower. *Id.* § 7872(c)(1)(B)-(C).

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There are two exceptions for gift loans between individuals. Section 7872 does not apply where the total amount of loans between the individuals is less than $10,000, unless the loan is used to purchase or carry income-producing assets.[134] The second, and potentially more important, exception is the $100,000 exception available for gift loans made directly between individuals.[135] If the aggregate loans between the lender and the borrower do not exceed $100,000 and do not have a principal purpose of avoiding federal taxes, the amount of the retransferred interest is limited to the amount of the borrower's net investment income for the year.[136] If the amount of the net investment income for the year does not exceed $1,000, the amount of net investment income for the year is deemed to be zero.[137] Thus, if the borrower's net investment income exceeds $1,000 for any tax year in which the loan is outstanding, the full amount of the borrower's net investment income is attributed and taxed to the lender. The proposed Treasury Regulations define tax avoidance very broadly;[138] therefore, qualifying for the $100,000 exception will be difficult.

The basic effect of I.R.C. § 7872 is to give harsh tax treatment to a "below-market loan" which is a gift loan.[139] The first deemed transfer is a gift, probably qualifying for the annual exclusion. If a gift tax is payable, the lender pays the gift tax after exhausting the lender's unified credit. The deemed transfer made at the end of the calendar year is income to the lender, and thus subject to the income tax.[140] The lender is therefore subject to both taxes.[141]

III. Considerations of Economics and Common Law

The rules governing the personal income tax should bear some reasonable relationship to economic reality and to the legal ramifications of statutory and common law rules. Accordingly, some basic economic ideas and related statutory and common law rules are discussed below.

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134. *Id.* § 7872(c)(2).

135. *Id.* § 7872(d)(1).

136. This limitation applies only to the retransfer; it does not limit the amount of the gift made by the first transfer.

137. I.R.C. § 7872(d)(1)(E)(ii) (1988).

138. Prop. Reg. § 1, 7872-4(e).

139. Interest free and low-interest loans between individuals that are designed as income-shifting devices will be gift loans.

140. If the borrower itemizes deductions, the deemed interest payment made to the lender at the end of the calendar year can be deducted as an interest payment. However, the interest deduction is in the process of being phased out. *See* I.R.C. § 163 (1988).

141. For a more detailed treatment of I.R.C. § 7872, see Mark D. Balk, *Interest-Free No Longer*, 123 Trs. & Ests. 39 (Sept. 1984).

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The private sector of our economy is made up of two groups: businesses and households.[142] Businesses employ individuals as workers, and sell goods and services.[143] Individuals live in households, earn income by working, and also purchase goods and services from businesses.[144]

From an economic perspective, a family is a cohesive, economically integrated unit, not a group of individual units.[145] The family is both a producing and a consuming unit.[146] The income of all family members may be pooled together and used in a variety of ways,[147] not always traceable to one or more family members.[148] A husband and wife, for instance, may use their income to make the mortgage payments, purchase groceries and clothing, and take vacations.[149] Often this is done without much thought as to whose income is used for which expenditures. Even if expenditures are assigned to one family member or another, the whole family unit benefits from each expenditure.[150] Income earned by children is used in a similar fashion to benefit the family unit. A child may have modest earnings, from a paper route or working part time at a fast food restaurant, for example. Occasionally, a child has significant earnings. The family unit determines, explicitly or implicitly,[151] how the child's income is used. The income may be saved for future educational expenses, thereby reducing later expendi-

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142. J.R. Clark & Michael Veseth, Economics: Cost and Choice 129 (1987).

143. *Id.* at 129-30.

144. *Id.* at 129, 131.

145. *See, e.g.*, Richard A. Posner, Economic Analysis of Law 127 (3d ed. 1986). Posner argued: "The persistence of the family as a social institution suggests to an economist that the institution must have important economizing properties." *Id.*

146. *Id.* Posner notes: "While marriage can be likened to a partnership, and the household to a small factory, there are important differences between business and familial organization." *Id.* at 129.

147. Jacob Mincer & Solomon Polachek, *Family Investments in Human Capital: Earnings of Women*, in Economics of the Family: Marriage, Children and Human Capital 397 (Theodore A. Schultz ed. 1973).

> It has long been recognized that consumption behavior represents mainly joint household or family decisions rather than separate decisions of family members. Accordingly, the observational units in consumption surveys are 'consumer units,' that is, households in which income is largely pooled and consumption largely shared.

Id.

148. In economic terms, there are three basic uses for income: consumption, savings and taxes. Clark & Veseth, *supra* note 142, at 133-34. For purposes of this article, it makes no difference which of these uses occurs. What is important is that in one way or the other the family unit receives benefit from its income.

149. The examples in this paper are based on personal consumption simply because consumption spending is the most significant use of income in the United States. *See* Clark & Veseth, *supra* note 142, at 134.

150. For example, a division of expenditures may be set by a prenuptial or a postnuptial agreement. Such a division usually does not affect the economic concepts discussed in this article.

151. Spending by the child without explicit input from the parents affects family use of the money spent; there is implicit consent to the child's spending decisions.

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tures from income or family savings. The income may be used to purchase clothing for the child, reducing parental expenditures for clothing. Unless the child's income is given away, the income serves to reduce the need to use other family resources.[152] Thus, the total combined incomes of the husband, wife, and children ought to be viewed as economic resources of the family. Similarly, the same may be true of a household consisting of persons not related by marriage. These types of households often operate in the same fashion as families.

In many respects, the common law treated the family as a single economic unit. The husband or father was the head of the family at common law.[153] In common law jurisdictions, the wife's income and earnings vested in her husband unless he had relinquished his rights to receive them.[154] With the advent of the Married Women's Property Statutes, however, wives gained the right to receive the income and earnings of their work and investments; these earnings no longer vested in a wife's husband.[155] In community property jurisdictions, the husband never possessed the right to receive a wife's income. Earnings of married people in community property jurisdictions are classified as community property, and thus have always belonged to the husband and wife equally.[156]

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152. It may be argued that families receive no economic benefit if children use their income for frivolous or illegal purchases. If the child is addicted to illegal drugs, for example, it is likely that the child will obtain money from some source in order to purchase the "needed" drugs. The family's "money" may not be immune from the child's search. Just as income produced by illegal activities, such as theft, ought not be factored into economic analysis, expenses for illegal activities ought not be considered. Both, however, are very realistic and difficult issues.

153. "By marriage, the husband and wife are one person in law: that is, the very being or legal existence of the woman is suspended during the marriage, or at least is incorporated and consolidated into that of the husband . . . ." 1 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 430. The consequences of this are detailed in CLARK, *supra* note 17, at 286-89.

154. *See, e.g.*, Vigilant Ins. Co. v. Bennett, 89 S.E.2d 69 (Va. 1955); Gulf Transp. Co. v. Allen, 46 So. 2d 436 (Miss. 1950); Farrington v. Richardson, 16 So. 2d 158 (Fla. 1944); Collier v. Collier, 32 A.2d 469 (Md. 1943).

155. *See, e.g.*, Mullins v. Riopel, 76 N.E.2d 633 (Mass. 1948); Detroit & Sec. Trust Co. v. Gitre, 235 N.W. 884 (Mich. 1931); Cragford Bank v. Cummings, 113 So. 243 (Ala. 1927); Walpole v. State Liquor Auth., 356 N.Y.S.2d 462 (N.Y. 1974).

156. *See, e.g.*, Martsch v. Martsch, 645 P.2d 882 (Idaho 1982); Shaw v. Greer, 194 P.2d 430 (Ariz. 1948); *In Re* Witte's Estate, 150 P.2d 595 (Wash. 1944); Frame v. Frame, 36 S.W.2d 152 (Tex. 1931). The following states are community property jurisdictions: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington. In general, community property is any property, including income, acquired by a husband, a wife, or by both, while married and while domiciled in a community property jurisdiction. However, property acquired by gift or inheritance does not become community property. *See* WILLIAM M. MCGOVERN et al., TRS. & ESTS. 137-40 (1988).

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At common law, the father was also entitled to a minor child's earnings.[157] This right continued until the child was no longer a minor,[158] unless the child was emancipated.[159] If, however, the child elected to remain at home with the parents and was supported by them after emancipation or reaching majority, the father's right to the child's income continued.[160] The father could relinquish the right to receive the child's income.[161] These rules continue to apply today.[162] For tax purposes, income earned by a child was taxed to the child, even if received by the father or another person.[163]

IV. POSSIBLE TAX UNITS

In most previous discussions, two possible tax units have been considered, the individual and married couples. Well reasoned support exists for designating the individual and married couples as tax units for the personal income tax. Additionally, considerable arguments against continuing joint filing for married couples exist. Other tax units are possible. While not establishing households as tax units, Congress has provided a separate tax rate schedule for heads of households.[164] The Canadian Royal Commission on Taxation recommended use of families as tax units,[165] including in its definition single parent families.[166] Single parent families are presently very common in the United States.[167] The Canadian Report also recommends that dependent children who live together be included in the definition of "family" even though they do not live with either parent.[168] Living situations also exist where persons who are not family members live together.[169] Therefore, considera-

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157. *See, e.g.*, Beaudoin v. Beaudoin, 386 A.2d 1261 (N.H. 1978); Peot v. Ferraro, 266 N.W.2d 586 (Wis. 1978); Cashen v. Riney, 40 S.W.2d 339 (Ky. 1931).

158. *See, e.g.*, *In Re* Cline's Estate, 202 N.E.2d 736 (Ohio P. Ct. 1964).

159. *See, e.g.*, Immel v. Richards, 93 N.E.2d 474 (Ohio 1950).

160. *See, e.g.*, Burdick v. Grimshaw, 168 A. 186 (N.J. Ch. 1933).

161. *See, e.g.*, Slater v. California State Auto Ass'n, 19 Cal. Rptr. 290 (Cal. Dist. Ct. App. 1962); Hines v. Cheshire, 219 P.2d 100 (Wash. 1950).

162. *See, e.g.*, Brower v. Brower, 331 S.E.2d 170 (N.C. Ct. App. 1985).

163. I.R.C. § 73(a) (1988).

164. *Id.* § 1(b).

165. REPORT OF THE ROYAL COMMISSION ON TAXATION, *reprinted in* 3 TAXATION OF INCOME PART A, 122-41 (Can. 1966) [hereinafter "The Canadian Report"]. The Canadian Report was never implemented; individuals remain the sole tax unit for the personal income tax in Canada.

166. *Id.* at 132-34.

167. In 1991, for example, there were 14,175,000 single parent families in the United States. 1992 ABSTRACT, *supra* note 12, at 53. Of these, 8,004,000 had children under the age of 18. *Id.*

168. The Canadian Report, *supra* note 165, at 133, 140. The 1992 ABSTRACT does not report information which can be identified with such living units in the United States.

169. There were 27,990,000 non-family households in 1991. 1992 ABSTRACT, *supra* note 12, at 56. In 1991, of all the persons in the United States fifteen years of age and older, twelve

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tion should be given to any scheme that establishes households as tax units for the personal income tax. Thus, four possible tax units will be considered: (1) individuals, (2) married couples, (3) families and (4) households.[170] Heads of households are not discussed as a possible tax unit because living units which qualify for this filing status meet the definitions of family and households.

A. The Individual as a Tax Unit

Historically in the United States, individuals have been the tax unit for the personal income tax.[171] Only since 1948 have married couples been permitted to file joint returns.[172] The individual continues as the tax unit, while married couples must choose between joint and separate filing. In many foreign countries, the individual is also the tax unit.[173] The individual is the tax unit in six countries: Canada,[174] Federal Republic of Germany,[175] Italy,[176] Japan,[177] Netherlands,[178] and Sweden.[179]

If the tax law in the United States returned to individuals as the sole tax unit, each individual, married or single, would be a separate taxpayer and joint filing would not be permitted. This would be a return to the pre-1948 scheme. Only one tax rate schedule would be needed, eliminating need for separate tax rate schedules for married people filing jointly, married people filing individually, or for heads of households.[180] Thus, each person, regardless of marital or family status, would be required to file an income tax return listing income and deductions. Each individual would be treated equally. The only potential administrative problem this would create is an increase in the number

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percent lived alone, twenty-six percent lived with relatives other than their spouse and six percent lived with non-relatives. *Id.* at 51.

170. As these alternate tax units are considered, the discussion in this Article demonstrates that regardless of which tax units are chosen by Congress, not everyone will be satisfied.

171. *See supra* notes 25-55 and accompanying text. "In the tax system it is most convenient, for reasons of history and ease of comprehension, to start with the notion of the individual filing his return for himself alone." Klein, *supra* note 6, at 363.

172. *See supra* note 27 and accompanying text.

173. JOESEPH A. PECHMAN, COMPARATIVE TAX SYSTEMS: EUROPE, CANADA, AND JAPAN (1987).

174. *Id.* at 341.

175. *Id.* at 265.

176. *Id.* at 215.

177. *Id.* at 410.

178. *Id.* at 91.

179. *Id.* at 5.

180. The reasons which led to the enactment of the head of household status would be removed by adopting individuals as the sole tax unit.

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of returns which would be filed.[181] The additional returns should not generate insurmountable workloads because of the current extensive use of computers by the Internal Revenue Service.[182]

Many advocates support a return to mandatory individual filing for various reasons.[183] Alicia Munnell, for example, argues that the "marriage tax," created by the reduction in the tax rate of single persons in 1969, is objectionable because of the increasing number of working women.[184] Munnell also argues that taxing the income of married women at their husband's marginal rate operates as a disincentive for married women to use their skills and abilities in gainful employment.[185] Professor Gann argued that an income tax ought to tax the person who earned the income, not the person who benefits from the income.[186] Gann also asserted that compiled data does not "substantiate the assumption that married persons equally share their income."[187] Louise Delude, writing to a Canadian audience, also argued in favor of basing the tax unit on the individual.[188] Delude also asserted that equal sharing of income by husbands and wives cannot be assumed.[189] Delude further argued that absent full income sharing, joint taxation of income

181. In 1987, for instance, 43,794,000 joint returns were filed. 8 Internal Revenue Service Statistics On Income Bulletin 3, 11 Table 1 (Summer 1988). In single earner couples, only one return would be filed. The number of returns filed by married couples who file joint returns would likely not double if there was a return to individual filing. In some instances, the second earner's income would be low enough that no return would be filed.

182. Combined returns with separate columns for the husband's income and the wife's income, deductions and tax computation, would minimize the number of returns and allow easy monitoring of consistency between returns filed by a husband and wife.

183. *See, e.g.*, Gann, *supra* note 31; Alicia H. Munnell, *The Couple Versus the Individual under the Federal Personal Income Tax*, in THE ECONOMICS OF TAXATION 247 (Henry J. Aaron & Michael J. Boskin eds. 1980); Kornhauser, *supra* note 5.

184. Munnell, *supra* note 183, at 263.

185. Munnell, *supra* note 183, at 263-64. The strength of this argument is weakened by the reduced number of tax brackets introduced by the Tax Reform Act of 1986. *See supra* text accompanying notes 88-90.

186. Gann, *supra* note 31, at 25.

187. Gann, *supra* note 31, at 26. "The exact amount of sharing among married couples is not known." *Id.* at n.97. Gann is not alone in making this assertion. However, this point does not necessarily weigh in favor of using the individual as the tax unit. Michael J. McIntyre, *Individual Filing in the Personal Income Tax: Prolegomena to Future Discussion*, 58 N.C. L. REV. 469, 484-85 (1980) (making this point as an argument in favor of joint filing).

188. Louise B. Delude, *Joint Taxation of Spouses—A Feminist View*, CAN. TAX., Winter 1979, at 8.

189. *Id.* Delude's argument is based on the [then] inequality which Canadian women had in marital property. After stating that "most spouses undoubtedly pool that part of their income that pays current household expenses, and although they use each other's assets to some degree (especially the home and its contents)," she asserts that studies have shown that the greater the income, the less the sharing. *Id.* "To the extent that married women and men have a choice, therefore, their natural inclination is usually to *not* share their income and assets with their spouses." *Id.* at 9-10.

penalizes the income earned by the wife.[190] The Winns also argued for mandatory separate filing,[191] advancing four perceived advantages:

> First, it eliminates the work disincentive for the second earner, because it does not begin taxation of the second earner's income at the marginal rate of the first earner, thus minimizing distortion in the second earner's decision to work outside the home. Second, mandatory separate filing simplifies the tax system and ends obfuscation of policy choices and effects caused by multiple tax rate scales. Third, mandatory separate filing ends the need to apologize for the effects of income splitting by removing income splitting from the tax system. Finally, the new scheme renders the tax system generally marriage neutral . . . .[192]

A recent article sheds more light on the extent of income sharing between couples, suggesting that it is not as extensive as once thought.[193] This validates the more intuitive assertions discussed earlier.

A return to use of the individual as the sole tax unit would have to be done cautiously. If Congress simply abolished joint returns and required married individuals to file individual returns, there would be a return to pre-1948 community property jurisdiction problems.[194] Community property rules required income splitting for residents of the community property states,[195] which was prohibited in common law states.[196] Recall that joint filing by married persons was allowed in 1948 in order to provide tax parity among residents of all states.[197] A return to the pre-1948 situation cannot be tolerated.

In order to return to the use of the individual as the sole tax unit, Congress would have to override *Poe v. Seaborn*.[198] A simple, complete Congressional override of *Poe v. Seaborn*, without more, would not provide sufficient guidelines for appropriate income attribution between married persons in community property states.[199] Some commentators believe that a Congressional override of *Poe* would be constitutional.[200] Congress would have to establish that income is taxed to the individual

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190. *Id.* at 9-10.
191. Winn & Winn, *supra* note 4.
192. Winn & Winn, *supra* note 4, at 869-70.
193. Kornhauser, *supra* note 5.
194. *See supra* notes 28-31 and accompanying text.
195. *See* Poe v. Seaborn, 282 U.S. 101 (1930). *See also supra* note 29 and accompanying text.
196. *See supra* text accompanying note 30.
197. *See supra* text accompanying notes 41-42.
198. 282 U.S. 101; *see supra* note 28.
199. *See, e.g.*, Gann, *supra* note 31, at 53-55.
200. *See, e.g.*, Gann, *supra* note 31, at 55-58; Bittker, *supra* note 26, at 1411.

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who earns it or whose property earns it. Such individual-based rules resemble the estate tax rules upheld in *Fernandez v. Wiener*.[201]

In 1942, Congress made changes to the federal estate and gift taxes which caused those taxes to sometimes operate contrary to state community property rules. The Revenue Act of 1942[202] amended the estate tax to require inclusion in a decedent's estate of all property owned by the decedent and the decedent's spouse with one limitation. This limitation applies to the extent that the surviving spouse could show such property "to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse."[203] A similar rule was provided for joint and community property interests.[204] Congress also provided that gifts of community property were to be considered gifts of the husband's property unless it could be proved to the contrary.[205] These estate tax provisions were upheld as constitutional in *Fernandez*.

If property ownership can be attributed from one spouse to another in this fashion, then for the purposes of the income tax, certainly income can be attributed to the person who earned it. Accordingly, Congress could require that income be reported by and taxed to the person who earned it or whose property earned the income.[206] If individuals were the tax unit, the incentive for income shifting between family members would be renewed. The individual earning the greater income would seek to shift income to the spouse earning the lesser income, or to one of their children. The tax reforms enacted in 1984 and 1986 which prevent, or limit, income shifting would need to be retained to make the individual an effective tax unit.[207]

Without income shifting as an easy alternative, the "Kiddie Tax" should be repealed; it is contrary to the underlying policy that individu-

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201. 326 U.S. 340 (1947).

202. Revenue Act of 1942, § 402, 56 Stat. 798.

203. *Id.* at 941-42.

204. *Id.*

205. *Id.* at 953.

206. Congress has actually considered such requirements. For instance, the House version of the Revenue Act of 1921 contained a provision that would have required that community property income be taxed to the spouse who had management and control of that property. In 1921, of course, the husband had management and control of community property. In 1941, the Senate Finance Committee proposed taxing community property wages to the spouse who earned the wages, and taxing community property investment income to the spouse who controlled the income. Other similar bills have been introduced in Congress, but none of them have ever been adopted.

207. *See supra* text accompanying notes 88-107.

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als should be taxed on their own income.[208] The major concern would be to insure that there was a single use of the minor's personal exemption.

Some may find a need to enact rules requiring family members to conform to a common pattern for deductions. Under current law, when a husband and wife file separate returns, they are required to either both take a standard deduction or to both itemize deductions.[209] A rule such as this is contrary to the concept that each individual is, and should be, a separate tax unit making his or her own elections. In some cases, deductions can be allocated between taxpayers, such as between a married couple or between parent and child. In recent years, however, many deductions have been eliminated or reduced in importance, thereby reducing the impact of such allocations. Thus, each individual should be free to elect whether to use standard or itemized deductions.[210] The same freedom should be extended to their children.

Utilizing individuals as the tax unit, a question arises in the family situation regarding which spouse is entitled to claim the personal exemptions for minor children who are not required to file their own income tax returns. The clear answer should be that if the minor child files a return, the minor child should use the personal exemption. The parent should not be permitted to claim this exemption.[211] If the minor child, however, is not required to file a return, the parents should utilize the benefit of the minor child's personal deduction.[212] Clearly, children would be able to utilize their own deductions if they file a tax return. If the safeguards discussed herein are retained, it is feasible for Congress to return to using individuals as the sole tax unit for the personal income tax.

B. The Married Couple as a Tax Unit

Under current law, married couples are able to file a joint income tax return, combining their incomes and deductions[213] and computing

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208. The "Kiddie Tax" has the effect of taxing most unearned income of a child under the age of fourteen years at the parents' marginal rate. *See supra* notes 96-100 and accompanying text.

209. I.R.C. § 63(c)(6)(A) (1988).

210. If it were politically prudent to mandate conformity in the deduction method used by husband, wife, and their children, that would not be a significant intrusion on the theory of only taxing individuals. It would be a nod to the probable economic reality of greater or lesser income sharing within most family units.

211. Single use of personal exemptions should be retained.

212. I.R.C. § 1(i)(7) (1988).

213. I.R.C. §§ 1(a), 63(b)(6). "The simple case of a man and woman who are legally married and living together is of course the prototype for a rule based on the notion of an economic unit." Klein, *supra* note 6, at 373.

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their income tax using a separate tax rate schedule.[214] Joint filing was originally enacted to provide tax parity across the nation. Married couples in the eight community property states had enjoyed the benefits of income splitting caused by joint ownership of community property income,[215] while married couples in the other states were not able to enjoy this benefit.[216] It was argued that the disparate results of the two different property systems should be resolved.[217] Thus, in 1948, Congress acted to resolve the protest which was sweeping the nation.[218]

When joint filing was first permitted, it was intended that the tax payable by means of joint filing would be less than the tax payable by means of separate returns filed by a husband and wife.[219] Current law furthers this intent.[220] This is not, however, always the case. Due to vagaries of the tax structure, a married couple will sometimes find that their total combined tax is reduced by filing separate income tax returns.[221]

Some writers argue that the Haig-Simons definition of income[222] supports joint filing by married couples.[223] Commentators posit that a married couple is an economic unit. There seems to be significant truth in this assertion. Our present system of voluntary joint filing, however, does not fully implement the theory. Married couples may file jointly or elect to file separate returns using a special rate schedule. No one has advocated mandatory joint filing by married persons, the logical result

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214. I.R.C. § 1(a) (1988). Of course, the husband and wife may elect to file separate returns; then each will use a special tax rate table or schedule. *Id.* § 1(d).

215. *See supra* notes 28-29 and accompanying text.

216. *See supra* notes 30-31 and accompanying text.

217. *See, e.g.*, Surrey, *supra* note 6.

218. Congress considered the enactment of community property legislation in common law states as a strong protest. *See supra* notes 32-43 and accompanying text.

219. *See supra* notes 41-43 and accompanying text.

220. *See* I.R.C. § 1 (1988).

221. *See, e.g.*, 1991 U.S. MASTER TAX GUIDE, par. 156.

222. "Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question." HENRY CALVERT SIMONS, PERSONAL INCOME TAXATION 50 (1938). Haig defined income as "the increase or accretion in one's power to satisfy his wants in a given period in so far as that power consists of (a) money itself, or, (b) anything susceptible of valuation in terms of money." Robert Murry Haig, *The Concept of Income—Economics and Legal Aspects* (1921), *reprinted in* AMERICAN ECONOMICS ASS'N, READINGS IN THE ECONOMICS OF TAXATION 54 (Richard A. Musgrave & Carl S. Shoup eds. 1959). McIntyre and Oldham assert that the Simons definition builds upon the Haig definition, resulting in the view "that it is the actual consumption or savings which is the proper object of taxation . . . ." McIntyre & Oldham, *supra* note 31, at 1576.

223. *See, e.g.*, McIntyre & Oldham, *supra* note 31.

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of the economic theory. At least one writer has urged caution about improper reliance on the Haig-Simons definition of income.[224]

Building on the more theoretical economic justification for joint filing presented by the Haig-Simons definition of personal income, McIntyre and Oldham conclude "that each family member should be taxed on the items he actually consumes or accumulates, regardless of source."[225] This leads to their proposal "that the total income earned by both husband and wife be treated as taxable in equal shares to each and that the tax imposed on each share shall be the same as that imposed on a single person with the same amount of income."[226] The McIntyre and Oldham proposal was the joint filing scheme adopted by Congress in the Revenue Act of 1948.[227]

The most significant effect of income splitting by use of joint returns is the reduction of the progressive rate feature of the income tax.[228] Prior to 1986, the tax advantage generated by income splitting increased rather dramatically as income increased.[229] With the reduced tax rates and limited progressivity now in effect, however, the maximum tax advantage available to married couples who file jointly is $3,731.[230] Another principal argument favoring joint filing is that married couples share their income within the marriage.[231] Arguably, this argument is stronger for married couples with lower income where

224. "One thesis of this paper is that the Haig-Simons definition of income has been used for purposes which it cannot properly serve. The definition is a useful tool, but it does more harm than good when its evaluative attributes are exaggerated." Douglas A. Kahn, *The Two Faces Of Tax Neutrality: Do They Interact or Are They Mutually Exclusive*, 18 N. KY. UNIV. L. REV. 1, 2 (1990).

225. McIntyre & Oldham, *supra* note 31, at 1576.

226. McIntyre & Oldham, *supra* note 31, at 1578.

227. *See supra* text accompanying notes 41-43.

228. JOSEPH A. PECHMAN, FEDERAL TAX POLICY 103 (5th ed. 1987).

229. *Id.*

230. *Id.* The maximum tax savings is achieved when taxable income is $80,000; by the time taxable income reaches $150,000, the tax savings for married couples filing a joint return is reduced to $1,934 and remains at this amount for all larger taxable income. *Id.* at Appendix D, Table D-10. This Table does not take into account the phase out of the personal exemption, but is sufficient to demonstrate the drastic change made by the Tax Reform Act of 1986. Prior to the new rate structure, the tax savings for a married couple filing a joint return showing taxable income of $80,000 was $8,450, and increased to $13,510 with taxable income of $150,000. JOESEPH A. PECHMAN, FEDERAL TAX POLICY, Appendix C, Table C-10 (3rd ed.). The maximum tax savings which could be achieved prior to 1986 was $14,510. *Id.*

231. PECHMAN, *supra* note 228, at 103. ("The classic argument in favor of income splitting is that husbands and wives usually share their combined income equally"). *See also* Michael McIntyre, *Economic Mutuality and the Need for Joint Filing*, CAN. TAX., Winter 1979, at 13. *Compare* Klein, *supra* note 6, at 370 ("The idea that husband and wife should be required to file as a unit [is] based primarily on the assumptions (1) that married couples share income and expenses and feel a strong mutual obligation of support and (2) that payments should be strictly tailored to need.").

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family needs may require sharing of incomes.[232] As joint income increases, the pressure for sharing of income decreases.[233] McIntyre argued that "exact sharing patterns of couples are unknown and probably unknowable, because sharing is often an unconscious act unaccompanied by careful record keeping."[234] However, McIntyre also believed that full sharing was "especially likely" when both spouses are employed "because financially independent spouses are unlikely to tolerate any other pattern."[235] According to McIntyre, income sharing should be the economic basis for joint filing.[236] Congress adopted joint filing to halt the spread of community property laws.[237] The income sharing economics theory was adopted later by writers who sought to defend joint filing.[238]

Professor Kornhauser's recent article[239] demonstrates that insufficient evidence exists to support the income sharing theory. Kornhauser first points out that there is little empirical evidence which supports income sharing.[240] Kornhauser then discusses her own informal surveys, concluding that "[t]he evidence from empirical studies indicates that neither assertions of pooling nor nominal arrangements of assets in a pooling arrangement accurately reflect the reality of financial arrangements. Behind the facade of sharing is a deep-seated, though often subtle, control of income by the earner spouse."[241]

Logically, the arguments by proponents of joint filing lead to mandatory joint filing by all married couples. Given the lack of empirical data on income sharing, I reject income sharing as a reason for joint filing. From an economic viewpoint, a married couple is not an appropriate tax unit unless no other persons live in that housing unit. There is, of course, the likelihood of children or others living with the married couple. Many other living units exist where people live to-

232. PECHMAN, *supra* note 228, at 104.

233. PECHMAN, *supra* note 228, at 104. It is Pechman's argument that

> [a]t the top of the income scale, the major rationale of income taxation is to reduce the economic power of the family unit, and the use made of the income at these levels for family purposes is irrelevant for this purpose. Obviously, these objectives cannot be reconciled if income splitting is extended to all income brackets.

Id.

234. McIntyre, *supra* note 187, at 469. "In most marital partnerships, the distribution of benefits from expenditures for housing, utilities, furnishings, insurance, food, transportation, vacations, taxes, support of children, and clothing are unlikely to favor one spouse over the other to a substantial degree." *Id.*

235. McIntyre, *supra* note 187, at 470.

236. McIntyre, *supra* note 187, at 470.

237. *See supra* notes 32-43 and accompanying text.

238. Zelenak, *supra* note 5.

239. Kornhauser, *supra* note 5.

240. Kornhauser, *supra* note 5, at 80.

241. Kornhauser, *supra* note 5, at 91.

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gether outside of marriage. Therefore, married couples should be rejected as an appropriate tax unit.

C. *The Family as a Tax Unit*

The idea of using the family as a tax unit has been previously suggested. The Canadian Royal Commission on Taxation (Commission) recommended the use of the family as a tax unit as part of a proposal for broad restructuring of Canadian taxation.[242] The Commission concluded that the Canadian tax system lacked essential fairness between families, and traced much of the unfairness to the use of individuals as the tax unit.[243] Accordingly, the Commission recommended using the family as a tax unit with a separate tax rate schedule applicable only to families.[244] The Commission believed that the income of various family members was shared by family members and contributed to the well-being of the family.[245]

To implement its proposal, the Commission proposed a definition of "family unit" which included five groupings:[246]

1) husband and wife, and their dependent children, if any;[247]
2) a surviving spouse and dependent children, if any;[248]
3) a divorced or separated parent and dependent children;[249]
4) dependent children who live together as a family unit but who are separated from both parents because of death or residence outside of Canada; and

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242. The Canadian Report, *supra* note 165, at 143.

243. The Canadian Report, *supra* note 165, at 122. According to the Report:

> Taxation of the individual in almost total disregard for his inevitable close financial and economic ties with the other members of the basic social unit of which he is ordinarily a member, the family, is in our view [a] striking instance of the lack of a comprehensive and rational pattern in the present tax system.

Id.

244. The Canadian Report, *supra* note 165, at 122. In addition to family units, the Commission recommended that individuals, marital units (husband and wife only), the broad family unit (all related persons living together), and household units (all persons living together) be tax units. *Id.* Klein, *supra* note 6, at 365-66.

245. The Canadian Report, *supra* note 165, at 122.

246. The Canadian Report, *supra* note 165, at 132-33.

247. Common law marriages with cohabitation of one year or more were recognized. The Canadian Report, *supra* note 165, at 142. Dependent children were defined as natural-born or adopted, unmarried, Canadian resident children under the age of 22. *Id.* at 133. A self-sufficient child under age 22 could withdraw from the family unit and full-time students could be retained within the family unit until age 25. *Id.*

248. A surviving spouse without any dependent child is treated as an individual, not as a family unit. The Canadian Report, *supra* note 165, at 153.

249. There must be at least one dependent child.

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5) in the case of adoption or an unmarried mother, an individual and dependent children.[250]

Within the family unit, the Commission recommended aggregation of the income of all family members and computation of the income tax using a separate rate schedule. At their option, a husband and wife could file as individuals,[251] but special computations almost always would result in a higher combined tax than if they filed as a family unit.[252]

The Canadian Commission based its recommendation for the use of the family as a tax unit partly on a standard of "ability to pay."[253] "Taxation in accord with 'ability to pay' is 'achieved when taxes [are] allocated in proportion to the discretionary economic power of tax units.' "[254]

> 'Discretionary economic power' is the product of the tax unit's total economic power (defined as the unit's power to command goods and services for personal use) and the fraction of that power available for 'discretionary use' by the unit, that is, which does not have to be exercised to maintain the members of the unit . . . .[255]

Accordingly, the Commission used the family as a tax unit to measure and pay income tax, and to allocate the burden of the income tax among various tax units.[256] This is similar to the considerations utilized by McIntyre and Oldham in applying the Haig-Simons definition of personal income as a justification for joint filing.[257]

Dean London also argued for a tax system which makes use of the family as a tax unit.[258] London argued that "[t]he family ought also to be considered a tax paying unit because it is a social and economic institution which, as a group, commands and benefits from combined income and assets to which our law has ascribed property rights."[259]

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250. A family unit terminates upon the death or non-residence of the last of the unit's members; the remarriage of a surviving spouse; divorce or legal separation (where another definition does not apply); or when both parents are not members of the family unit, when the last dependent child leaves the family unit. The Canadian Report, *supra* note 165, at 128-30, 139-40.

251. The Canadian Report, *supra* note 165, at 126, 134.

252. The Canadian Report, *supra* note 165, at 189.

253. The Canadian Report, *supra* note 165, at 5.

254. The Canadian Report, *supra* note 165, at 5.

255. The Canadian Report, *supra* note 165, at 5.

256. The Commission also used the family as a tax unit for purposes of transfers between and within tax units, a topic beyond the scope of this paper.

257. *See supra* notes 222-23 and accompanying text.

258. John London, *The Family as the Basic Tax Unit*, CAN. TAX., Winter 1979, at 4. London's income tax would have three tax units: (1) "unattached individuals" (single persons), (2) "married couples with no dependent children," and (3) "family units," defined as married couples and their dependent children. *See id.*

259. *Id.* at 5.

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> In other words, in my view, the reality of the family (which includes spouses and dependent children), as a group, is one of economic mutuality which, though it differs in degree from unit to unit, is one sufficiently meshed economically, ordinarily, to consider it a unit for purposes of determining taxpaying capacity. . . . But if families are economic units, then, in order to achieve both horizontal and vertical equity, we have to calculate the income of the unit as being the aggregate of notional titles of each member of the family to income. To do otherwise is to offend against the basic principles of ability to pay."[260]

McMahon suggested aggregating children's income with that of their parents.[261] Professor Bittker reported that: "[b]y and large, tax theorists have espoused the doctrine 'that taxpaying ability is determined by total family income regardless of the distribution of such income among the members of the family.' "[262] In France, the income of a husband, wife and all unmarried children under age eighteen is combined on one tax return.[263]

If the Haig-Simons definition of income is accepted,[264] the definition would seem to require taxing a family as a tax unit instead of taxing a married couple as a tax unit. All the arguments and justifications in the discussion of married couples as tax units apply with equal validity here. Likewise, the income-sharing justification[265] applies to families just as much as it does to married couples.

If the family comprised the tax unit, all income received by members of the family would be combined and reported on a single return. All exemptions and deductions applicable to the members of the family would likewise be combined and claimed on the same single return. Single persons living alone constitute a family unit, although some theorists would maintain individual filing for these taxpayers.[266] The question of how to define a family unit is explored below.

Congress has already taken some steps to utilize the family as a tax unit. Double use of personal exemptions has been abolished.[267] Thus, children who are claimed as dependents on the parents income tax return(s) cannot claim an exemption on their own income tax re-

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260. *Id.*

261. Martin J. McMahon, Jr., *Expanding the Taxable Unit: The Aggregation of the Income of Children and Parents*, 56 N.Y.U. L. REV. 60 (1981).

262. Bittker, *supra* note 26, at 1392. *See also* Nancy E. Shurtz, *A Critical View of Traditional Tax Policy Theory: A Pragmatic Alternative*, 31 VILL. L. REV. 1665, 1693 (1986).

263. PECHMAN, *supra* note 173, at 157.

264. *See supra* note 222.

265. *See supra* notes 231-41 and accompanying text.

266. *See, e.g.*, London, *supra* note 258.

267. *See supra* notes 92-95 and accompanying text.

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turn.[268] The "Kiddie Tax" taxes unearned income of minor children below fourteen years of age at the parents' marginal tax rate, thus preventing a free bracket ride.[269] The standard deduction for children who file their own income tax returns, but who are claimed as exemptions on a tax return filed by a parent, has been reduced as well.[270] The grantor trust rules and the below-market interest rules both eliminate substantial income shifting from parents to other family members.[271] Thus, in many ways the family is already a *de facto* tax unit, although the income tax does not tax the family as a unit.

Defining family units may prove difficult. There are, however, a number of easy cases. A husband and wife living together are clearly a family, with or without dependent children. But proper treatment of children is likely to be fraught with difficulty. Minor, dependent children living in the parents' home clearly are within the family unit. When children begin to leave the home, however, problems arise. When a child moves into a college dormitory, for example, has the child left the family? Does it matter whether the parents still support the child? What if the child has a partial scholarship, uses some money the child has earned, and the parents contribute the rest of the educational expense for the academic year? How should we treat that child? Suppose that a child moves back into the home upon graduation in order to save money to later move into an independent living situation. Is this now employed adult child a member of the family for income tax purposes?

Dictionary definitions do not allow us to adequately handle these common situations.[272] Legal dictionaries offer no greater help.[273] The

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268. Recall that prior to this change, children had their own exemption even though they were claimed as dependents on their parents' returns. *See supra* text accompanying notes 92-95.

269. *See supra* notes 96-100 and accompanying text.

270. *See supra* text accompanying note 97.

271. *See supra* text accompanying notes 101-41.

272. Webster's New World Dictionary of the American Language (college ed. 1957) defines "family" as:

1. all the people living in the same house.
2. (a) a group consisting of the two parents and their children.
   (b) the children of the same parents.
   (c) one's husband (or wife) and children.
3. a group of people related by blood or marriage; relatives . . . ."

Id. at 525.

273. Black's Law Dictionary 727 (4th ed. 1968) defines the word family by stating "[t]he word is used to designate many relationships." *Id.* Black's continues: "In broad or primary sense 'family' means: a collective body of any two persons living together in one house as their common home for the time . . . ." *Id.* This definition is not related to the common ideas which require a blood relationship. Later in the definition, we find: "In most common use, the word implies father, mother and children, immediate blood relatives." *Id.* at 728. Ballentine's Law Dictionary (3d ed. 1969) is similar: "A word of great flexibility, its meaning varying according to the connection in which is appears . . . . Primarily, the collective body of persons who live in one

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definition used in the Statistical Abstract is more helpful: "The term 'family' refers to a group of two or more persons related by birth, marriage, or adoption and residing together in a household."[274] This definition could be the working definition, but it fails to provide answers to specific questions which would naturally arise.

The Internal Revenue Code's definitions and guidelines pertaining to personal exemptions offer potentially useful possibilities to deal with specific cases, because over the years many similar questions have arisen concerning personal exemptions.[275] Consider, for example, the child going off to college. One could suggest that as long as a child qualifies as a personal exemption for the parents, the child should remain a member of the family unit for income tax purposes.[276] Once the child no longer qualifies as a dependent, the parents should lose the personal exemption, and the child then becomes its own taxpaying unit. The current rules used to determine personal exemptions are not unduly difficult to administer.

Will the personal exemption rules offer solutions to deciding whether other common living arrangements are family units? If a parent moves in with a child and becomes dependent upon the child, the parent becomes a part of the child's family and the child may take the parent as an exemption if the child provides a majority of the parent's support.[277] Likewise, if a brother or sister moves in with a taxpayer and becomes dependent upon the taxpayer, the taxpayer may claim the sibling as an exemption.[278] If the parent or sibling was not financially dependent upon the taxpayer, then no personal exemption could be claimed[279] although the parent or sibling might otherwise be considered part of the family unit.

There are, however, situations which pose more difficulty. How are unmarried couples who live together handled? Unmarried couples do not qualify for joint filing under present rules because they are not married,[280] but the exemption rules allow one to claim the other as a

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house and under one head or management; secondarily, those persons who are of the same lineage, or have descended from one common progenitor." *Id.* at 456.

274. STATISTICAL ABSTRACT OF THE UNITED STATES 5 (1990).

275. *See* I.R.C. §§ 151, 152 (1988).

276. A child under the age of twenty-four years who is a student qualifies for a personal exemption. *Id.* § 151(c)(1)(B)(ii).

277. A "dependent" can include a parent. *Id.* § 152(a)(4). The dependent parent may thus qualify for a personal exemption. *Id.* § 151(c)(1).

278. *Id.* § 152(a)(3).

279. *Id.* § 152(a) (requiring that the taxpayer claiming an individual as a dependent must contribute over half of their support during the tax year).

280. The Internal Revenue Code provides: "A husband and wife may make a single return jointly . . . ." *Id.* § 6013. An unmarried couple who live together but whose relationship does not constitute a common law marriage recognized by the state of their residence may not file a joint

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dependent,[281] unless state law is violated by the relationship.[282] Dependent children of unmarried couples can currently be claimed as a dependent by one or the other parent.[283] The dependent children are claimed as personal exemptions under the current rules, qualifying that taxpayer for head of household status.[284] This, however, simply allows use of a more advantageous tax rate schedule without bringing the other member of the "couple" into the tax unit as a joint filer or as a dependent. If the personal exemption rules were adopted as the basis for defining a family as a tax unit, many groups that are commonly considered a family unit would not be treated as a family unit for tax purposes.

The most difficult problem is presented by same-sex couples living together. There is no doubt that they would not be allowed to file a joint return under current law.[285] Yet, the economic reasons for considering a family as a tax unit apply to these couples the same as to a heterosexual couple, regardless of whether the couple is married or not. This illustrates only one of the situations which might be better addressed by use of households as the tax unit.

Families could be tax units. Many common living situations, however, do not fall comfortably within the proffered definitions, yet do fall within the economic concept of a tax unit. Concepts based on households as tax units do not generate these difficulties. Therefore, I believe it would be unwise to adopt families as tax units.

D. *The Household as a Tax Unit*

The economic reasons for considering a family as a tax unit and the definitional problems encountered when trying to define "family" lead one to consider using households as tax units. The idea of using households as tax units for the personal income tax is rarely discussed.

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return. *See, e.g.*, Ochs v. Commissioner, 52 T.C.M. (CCH) 1218 (1986); Peveler v. Commissioner, 39 T.C.M. (CCH) 502 (1979).

281. M. M. Shackelford, (BC-DC) 80-1, U.S.T.C. Par. 9276.

282. Eichenbauer v. Commissioner, 30 T.C.M. (CCH) 581 (1979); Martin v. Commissioner, 32 T.C.M. (CCH) 656 (1973).

283. A son or daughter of a taxpayer can be a dependent. I.R.C. § 152(a)(1) (1988).

284. *Id.* § 2(b)(1)(A)(i).

285. State courts generally have refused to recognize or allow marriages between homosexual couples. *See, e.g.*, Baker v. Nelson, 191 N.W.2d 185 (Minn. 1971), *appeal dismissed*, 409 U.S. 810 (1972); Singer v. Hara, 522 P.2d 1187 (Wash. Ct. App. 1974); *see also* Bowers v. Hardwick, 478 U.S. 186 (1986). For other legal matters, however, homosexual couples have been found to be a "family." *See, e.g.*, Hann v. Housing Auth., 709 F. Supp. 605 (E.D. Pa. 1989); Braschi v. Stahl Assoc., 543 N.E.2d 49 (N.Y. 1989). Lately the Supreme Court of Hawaii has ruled that the state's laws which prohibit same-sex persons from marrying violate the Equal Protection provisions of the Hawaii Constitution. Baehr v. Lewin, 852 P.2d 44 (Haw. 1993).

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As we have seen, family units are a problematic tax unit for the personal income tax. Some groupings fit the description of a family rather easily, other groupings fit awkwardly. Still other groupings which are economic living units do not fit the definition of a family at all. Those groupings which meet the definition of family unit would also meet the definition of a household. Other groupings would meet the definition of a household even if they were not considered a family. The question to be examined is whether the household is a suitable tax unit.

Households are evaluated as units for census purposes. The Bureau of Census defines a household as:

> all persons who occupy a 'housing unit,' that is, a house, an apartment or other group of rooms, or a single room that constitutes 'separate living quarters.' A household includes the related family members and all unrelated persons, if any, such as lodgers, foster children, wards, or employees who share the housing unit. A person living alone or a group of unrelated persons sharing the same housing unit is also counted as a household.[286]

This definition could serve as a starting point for a suitable definition to describe a tax unit. This concept of households is more workable than using the family as a tax unit or using the personal exemption rules discussed above.[287]

Each of the living situations considered while discussing the family as a tax unit would meet the definition of a household. Recall that the Canadian Royal Commission of Taxation recommended that five groupings of people meet the definition of a family unit.[288] Each of these groupings also meets the Bureau of Census' definition of household. Clearly, a husband and wife, with or without dependent children, constitute a census-defined household, as do single parents (divorced, separated, widowed or unmarried) with or without dependent children. Dependent children living together as a family unit but separated from both parents are also a household using this definition.

Likewise, the other living situations considered in the discussion of the family as a tax unit meet this definition. When children go to college without changing their legal residence, the children remain part of a household.[289] If a child moves in to live with one or both parents, that child clearly becomes a part of the parents' household using this defini-

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286. 1992 ABSTRACT, *supra* note 12, at 6.

287. *See supra* notes 266-85 and accompanying text.

288. *See supra* note 246-50 and accompanying text.

289. The personal exemption rules examined above also provide adequate guidance for this situation. *See supra* text accompanying note 276.

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tion. If a parent moves in with a child, or a brother or sister moves in with one or more siblings, the person who moves in becomes a part of the existing household into which the move was made. It is equally clear that unmarried persons who live together, with or without children, heterosexual or same-sex, constitute a household within this definition.

The only relationships caught up in the Bureau of Census' definition of household which would seem to create problems from a tax policy standpoint are the inclusion of lodgers and employees. Logically, and seemingly from a tax policy standpoint, paying lodgers should each be their own tax unit or be part of a different household, as should employees.[290] Foster children and wards would seem to be natural parts of the household in which they live. Thus, this definition of household provides a very good foundation for defining households as tax units.

Considered from an economic perspective, in all these situations it is extremely likely that basic living expenses are shared approximately as in a marriage, and in many of these situations income is likewise shared. Using the Haig-Simons definition of income,[291] we find that the very reasons which are used to justify joint filing by married couples[292] apply equally to households to justify their use as a tax unit. A household is an economic unit.[293] Economic theory tells us that our economy is comprised of two groups, businesses and households,[294] and that individuals live in households.[295] Households, much like families, likely share income and make many joint consumption decisions.[296] Thus, members of a household will normally share their income for rent, mortgage payments and payment of real estate taxes. They will usually share expenses of food, but not necessarily expenses of clothing. Surely the living units commented upon above are economic units in which there will likely be considerable sharing of income and expenses. Thus economic theory supports using households as tax units just as it supports joint filing by a husband and wife. Keep in mind, however, the recent available empirical evidence that indicates the prominence of income sharing is less than economists and earlier writers asserted.[297]

Some groups of persons who live together should not be considered households. Suppose that a group of college students live together in an

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290. Paying lodgers and employees have much more independence and are less likely to pool income and share in expenses as might others within the household.

291. See *supra* note 222 for the definition.

292. *See supra* text accompanying notes 222-27.

293. *See supra* text accompanying notes 145-63.

294. CLARK & VESETH, *supra* note 142.

295. CLARK & VESETH, *supra* note 142, at 129, 131.

296. *See supra* notes 145-50 and accompanying text.

297. Kornhauser, *supra* note 5, at 67.

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apartment. Each may be claimed as a dependent by their respective parents. Yet they will most likely be sharing the expenses of obtaining and maintaining the apartment,[298] and also the costs of food which they consume in the apartment. It is just as likely that they will not be sharing the costs of clothing, tuition and books, although there may be some sharing of actual articles of clothing and of books. The apartment will probably contain one or two telephones, one or two televisions, and perhaps one or two stereo systems.

Older siblings who live together may be in a similar situation, sharing many, but not all, living expenses. As with college students, income of each sibling will not be available for some of the expenses of the other siblings. Perhaps the best way to handle these situations is to allow members of a household to seek an exemption from mandatory joint filing.[299] With a strong, but rebuttable, presumption that there should be joint filing by all members of a household, use of the household as a tax unit is workable. In that event, joint filing and head of household filing should be abolished, because the persons who qualify for these filing statuses would file as households.

If households were established tax units, the recent changes in the tax law[300] would not be adversely affected. Double use of exemptions would not arise because children and other dependents would be claimed only on the single income tax return filed for the household. The "Kiddie Tax" would need to be repealed, because all the child's income would be disclosed on the single income tax return filed for the household. From a tax policy standpoint, the use of households as tax units provides a better alternative than the "Kiddie Tax." The new grantor trust rules would not be adversely affected, but the rules which govern below-market interest loans between members of a household would need to be restructured or eliminated.[301]

Currently, the Internal Revenue Code has four separate rate schedules in Section 1.[302] If households were adopted as tax units, the rate schedules for married persons filing jointly and for heads of house-

298. It is extremely likely that rent deposits and rent payments will be shared, as will the costs of utilities.

299. In The Netherlands, people who share a household and pool their income are treated like married couples but may try to obtain an exemption from joint filing. PECHMAN, *supra* note 173, at 8.

300. *See supra* notes 88-108 and accompanying text.

301. Congress might consider making these transactions subject to the gift tax, as the Supreme Court did in Dickman v. Commissioner, 465 U.S. 330 (1984).

302. I.R.C. § 1(a) is the rate schedule for married persons filing joint returns and for certain surviving spouses. I.R.C. § 1(b) is the rate schedule for heads of households. I.R.C. § 1(c) is the rate schedule for unmarried individuals. I.R.C. § 1(d) is the rate schedule for married individuals filing separate returns.

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holds would be repealed. In their place, a new rate schedule for households would be adopted.[303] It would be impractical to adopt various rate schedules for various household arrangements. Instead, the personal exemptions of each member of the household would be utilized on the household's income tax return.[304] The deductions, whether standard or itemized, would also be used on the household's income tax return.[305]

It is appropriate that the rate schedule currently used for married couples who file joint returns should be the rate schedule enacted for household returns. Married couples are included in the definition of households, but many other living units would also be included in the definition.

A rate schedule for members of a household filing separate returns as households is not needed. If members of a household file separate returns, they should be considered as individuals and should use the tax rate schedule adopted for individual filings. It should be clear, however, that either all members of a household join in the household return, or alternatively, all members of the household file individual returns, each claiming their own personal exemptions and deductions.

Because households can be clearly defined for tax unit purposes, and because the household is a recognized economic unit, use of households as tax units for the personal income tax is quite feasible.

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303. This is similar to the recommendation of the Canadian Report. The Canadian Report, *supra* note 165.

304. It should be noted that the rules governing use of personal exemptions are well developed. Treas. Regs. §§ 1.151, 1.152 (1994). Some works devote considerable space to the application of these Regulations. For example, RIA, Federal Tax Coordinator 2d, Volume A, devotes 29 pages to this topic, beginning at page 12,106A. There should be no difficulty applying these Regulations to households.

305. Again, this recommendation is similar to a recommendation in the Canadian Report.

> As has been previously mentioned, we recommend the use of tax credits rather than separate rate schedules to allow for the non-discriminatory expenses associated with dependent children. It might seem preferable to establish a separate rate schedule for each different family type that had different responsibilities, and, therefore, different amounts of non-discretionary expenses. However, there are many differences between family responsibilities, such as the differences between families with dependent children and families with other dependents, the difference between either of these families and a tax unit supporting a student at a university or post-secondary vocational school, and the differences between otherwise similar families with school-age children where the wife is or is not working. Because of the many combinations of these differences, it is not administratively feasible to provide for them by establishing a separate rate schedule for each situation. Consequently, we must allow for these differences either by deductions from income or by tax credits.

The Canadian Report, *supra* note 165, at 178-79.

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V. Conclusion

This article reviewed the development of the use of the individual as a tax unit for the personal income tax, and the 1948 changes which allow married individuals to file a joint return. The serious problems caused by income-shifting prior to the 1986 changes in the Internal Revenue Code were examined as well. The changes Congress enacted in 1986 which essentially have removed the income-shifting problem were discussed. Income attribution was also studied to understand how income attribution facilitates the use of individuals as the tax unit. Economic theory was reviewed as an additional foundation for the four possible tax units; individuals, married couples, families, and households.

In conclusion, a return to using the individual as the sole tax unit is feasible. Specifically, each person would be taxed on income earned by that person and property owned by that person. Community property rules would be ignored for purposes of the income tax. In addition, the changes made by the Tax Reform Act of 1986 mandating single use of personal exemptions, and reducing the attraction and effectiveness of income-shifting schemes would need to be retained. If those changes are retained, there will not be a return to the "tax evasion" caused by income shifting. Joint filing by married couples and the head of household status and tax rates would be repealed.

The concept of using married couples as tax units was rejected. From an economic standpoint, married couples are an improper tax unit, and those living units which approximate married couples are not treated as a tax unit. Families are likewise rejected as tax units because they are not always the proper economic unit to tax and because there are difficulties in fitting certain living units into the definition of a family.

Households are proper tax units. Most living units fit easily within the definition of household. A mechanism allowing individuals to seek approval from the tax authorities to file as individuals would resolve the most difficult cases. Households are appropriate economic units to tax. Congress would need to establish a suitable tax rate for households.[306]

Accordingly, I urge that there be further study and discussion aimed at establishing households as the tax unit for the personal income tax. If this theory is ultimately rejected, a return to the use of the individual as the sole tax unit is urged, accompanied by repeal of joint

306. It would be appropriate to use the tax rate schedule presently used for heads of household or joint filing by married persons.

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filing for married couples and repeal of the separate rate schedule for heads of households.

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