ISSUES IN NEW YORK STATE TAX REFORM

TAX CONSEQUENCES OF FAMILY SHARING PRACTICES UNDER NEW YORK LAW: A CRITIQUE AND A PROPOSAL FOR REFORM

Michael J. McIntyre*

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INTRODUCTION

The New York personal income tax is ripe for reform. Although its graduated rates have been adjusted from time to time, the basic rate structure set in the 1930's remains largely intact. The rate structure has endured despite the enormous changes in the distributional impact of the rates that have been wrought by succeeding decades of economic growth and inflation.\(^1\) At its inception, the New York family taxation system conformed to the structure of the federal system,\(^2\) but in 1948, when the federal government abandoned the then-existing separate filing system for telling reasons,\(^3\) New York did not respond. The New York tax base, however, has been changed often, typically in response to changes in the Internal Revenue Code but also in response to short-term political exigencies at the state level. The resulting tax base is complex and unprincipled and is the cause

\(^1\) In 1935, New York adopted a six-bracket rate structure, starting at two percent and ending at seven percent. See 1935 N.Y. Laws ch. 35, § 351, at 395-96. The rates and bracket widths adopted at that time remain in the current law. See N.Y. Tax Law § 602(a) (McKinney Supp. 1984-1985). Since 1935, eight more brackets have been added, but without any change in the width of the first five brackets or in the rates applicable to them.

\(^2\) The first New York personal income tax was adopted in 1919, just six years after Congress enacted the federal income tax statute. See 1919 N.Y. Laws ch. 627. The marginal rates began at one percent on income not exceeding $10,000 and reached the top rate of three percent on income exceeding $50,000. Id. § 351, at 1639. A husband and wife living together with an aggregate net income of $2,000 or over were each required to file a separate return unless they filed a joint return. Id. at 1649. The right to file a joint return was never explicitly granted, nor were the filing requirements of spouses not living together discussed. By clear implication, however, married persons not filing joint returns were to be taxed on their separate incomes (however determined), and those filing joint returns were to be taxed on their aggregate income at the same rate applicable to those filing separately.

of much unfairness and inefficiency.

Recognizing the desirability of comprehensive reform, the New York State Legislature, in 1981, established the Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law (Tax Study Commission). The Legislature gave the Tax Study Commission a mandate to develop proposals for reform of the entire New York tax structure, including the personal income tax. The difficult and time consuming staff work necessary to formulate and support a set of reform proposals is now being completed.

The issues that policymakers must confront in designing fair and simple family taxation rules are many. To resolve those issues, New York policymakers must decide what tax consequences should follow from the fact that family members frequently share some or all of their separate incomes. Because of marital sharing, most married persons enjoy approximately the same standard of living as their mate. Similarly, dependent children typically have the same standard of living as their parents. The wages and other income sources of a family member, therefore, may be a poor index of a family member's economic well-being. This commonplace fact of family living arguably is relevant in setting tax burdens. If it is relevant, then policymakers must determine the proper response of the tax system to it.

Determining how to relate the tax burdens on single persons to those on married persons, however, is only one of the family taxation issues that policymakers must confront. Similar problems arise in de-

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4 See 1981 N.Y. Laws ch. 50. The Tax Study Commission was charged
(a) to review the tax law and the way in which it is administered to determine the effectiveness of such law and administration in achieving State policy goals, while achieving the traditional objectives of simplicity, fairness, ease of administration and equity; and
(b) to make recommendations to the legislature for such actions as it determines necessary to the achievement of those goals.

Id. at 289.


4 Consider, for example, two individuals, each earning $15,000. One is single and living alone; the other is married and has a spouse earning $75,000. Should these two individuals pay the same tax because they each earn the same amount of money? Or in determining taxable capacity, should a tax system take into account the fact that a married person with a prosperous spouse almost certainly can maintain a higher standard of living than a single person without this economic advantage?

The flip side of this example raises similar issues. Consider two individuals, each earning $30,000. One is single and the other is married to a spouse who has no independent income sources. Do both individuals have the same ability-to-pay? Or should policymakers recognize, when they specify the relative taxable capacities of single and married persons, that two persons sharing $30,000 cannot live on the same scale as a single person with the same income?
signing a tax system to treat similarly situated married persons fairly. Income sharing between parents and their minor children presents analogous policy issues, because parents typically enjoy a lower material standard of living than persons with equal incomes who don’t have children. Policymakers must decide whether the impact of children on the family standard of living should be a factor in establishing tax burdens. That is, they must decide whether or not parents should be grouped with equal-income persons without children for horizontal equity purposes.

Tax analysts have offered policymakers much advice on how to resolve the issues raised above. Unfortunately, much of their advice is contradictory. At one end of the spectrum are those analysts who argue that an income tax should focus exclusively on an individual’s wage and investment income and should ignore the impact on living standards that typically flow from marital and family income sharing. These analysts contend that changes in an individual’s living standard that result from personal choices — the decision to marry, the decision to propagate — are not relevant in determining taxable capacity. At the other end of the spectrum are those analysts who argue that an income tax should attempt to measure the changes in economic well-being that result from communal sharing of income, including, in principle, income shared outside the family. Most tax jurisdictions, including the United States and New York State, have adopted family taxation rules that reflect an ad hoc compromise of these two polar positions.

Most of the debate in the United States over the proper tax treatment of the family has occurred in the context of the federal income tax. Within the federal context, the design of a system of family

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7 Consider, for example, two equal-income married couples, both with total income of $80,000. In one of the marital partnerships, each spouse has earnings of $40,000. In the other, one spouse has earnings of $10,000 and the other has earnings of $70,000. Should each of the four spouses be taxed on their separate earnings, with the result that the couple with the $70,000/$10,000 income split would pay higher total taxes under a graduated rate structure than the couple with the $40,000/$40,000 split? Or should both couples bear the same tax burden, on the ground that all four spouses have the same ability-to-pay?

8 For example, does a family of six sharing an income of $25,000 have the same taxable capacity as a single person with $25,000 of income?


taxation is largely independent of the policy choices made by other taxing jurisdictions. A subnational tax jurisdiction like New York, however, does not enjoy the same degree of independence. As a practical necessity, the state must design its tax system so that it can be enforced largely through information reported by taxpayers on their federal tax returns or uncovered by Internal Revenue Service (IRS) audit programs. Furthermore, if the state wishes to have an income tax that is simple for taxpayers to comply with, it must minimize the number of determinations and calculations that taxpayers must make solely for state tax purposes. These administrative concerns provide a weighty, perhaps incontrovertible, reason to construct New York's family taxation system upon a joint filing foundation.

This Article is based on a report submitted to the Tax Study Commission. It examines the strengths and weaknesses of New York's current system of family taxation, including its well-intentioned but inadequate mechanisms for granting relief to low-income households. Section I of this Article discusses the grounds for choosing between separate and joint filing rules. Section II provides an analytical summary of New York tax provisions designed to accommodate the family circumstances of taxpayers. Section III evaluates those provisions in light of policy goals that a personal income tax should advance. Section IV offers a concrete set of reform proposals. To avoid issues concerning the design of the rate structure and the tax base that are not germane to the design of family taxation rules, this Article assumes that the reform proposals would be part of a comprehensive reform package that is revenue-neutral, that eliminates undesirable or administratively unmanageable deductions and exclusions from the tax base, and that brings the graduated rate structure into line with the practical redistributive goals of the voting public.

I. THE CHOICE BETWEEN JOINT AND SEPARATE RETURNS FOR MARITAL PARTNERS: AN OVERVIEW

This section of the Article is divided into three subsections. Subsection A summarizes the policy debate that has been carried on during the past decade between commentators favoring individual filing and those favoring joint filing. In subsection B, the several types of

(providing a thorough analysis of the debate over the proper tax treatment of the family).

12 See New York State Legislative Comm'n on the Modernization & Simplification of Tax Admin. & the Tax Law, The State Personal Income Tax: Taxation of the Family and Low Income Relief (June 20, 1984).
joint filing regimes are discussed, with brief notations on their respective merits. The case for a joint filing rule ultimately rests upon the merits of its basic premise that marital partners typically share their respective separate incomes to a substantial degree. Subsection \( C \) discusses the evidence that can be cited to support or refute that premise.

A. Joint Versus Separate Returns

There are two major approaches to the taxation of married couples: (1) the use of separate returns, with each spouse filing individually and reporting his or her own gross income and deductions, and (2) the use of joint returns, with marital partners combining their individual incomes and deductions as a step in the computation of their tax liabilities. Both of these approaches have broad support in academic quarters and from taxpayers, and both arguably reflect at least some of the economic and social realities of modern marriages.\(^{13}\)

Advocates of a joint return contend that a personal income tax should tax equally both members of a marital partnership, without regard to their individual incomes and deductions.\(^{14}\) This policy prescription rests upon two contentious but supportable premises. First, it assumes that both members of a marital partnership enjoy approximately the same standard of living, either because the spouses are sharing much of their separate incomes or because their separate incomes are approximately equal. Second, it assumes that an individual’s ability-to-pay is a function of the living standards he or she actually enjoys, regardless of which spouse finances that living standard. That is, a spouse’s taxable capacity is not accurately reflected by his or her separate income. This theory of taxation is called the “benefit principle,” which holds that income should be taxed to the person whose economic well-being is enhanced by the income.\(^{15}\)

\(^{13}\) For a helpful summary of the debate among the leading commentators, see Lathrope, State-Defined Marital Status: Its Future as an Operative Tax Factor, 17 U.C.D. L. Rev. 257, 267-71 (1983).

\(^{14}\) See McIntyre, supra note 10, at 472-73. Historically, joint return systems were favored by many commentators because they eliminated the bias of the pre-1948 federal separate return system in favor of couples residing in the eight community property states (Arizona, California, Louisiana, Idaho, Nevada, New Mexico, Texas, and Washington). See Bittker, supra note 11, at 1412-14. This justification has no relevance to New York, which has a unified system of property law.

\(^{15}\) The benefit principle probably underlies most of the arguments that have been made over the years on behalf of the joint return. In the context of the normative treatment of the family,
The competing view is that a tax system should ignore marital status and should tax single and married persons on their "own" incomes, i.e., the incomes they actually earn or that are generated by their assets. Some commentators defend this position on the ground that marriage is not a tax-significant event, but rather a private arrangement between individuals that should be of no concern to the tax collector. Most advocates of joint returns would not dispute that claim; they would respond, however, that the purpose of the joint return is to adjust burdens for economic consequences of marital sharing, not for the fact of marriage itself.

Commentators also challenge the case for joint returns on the ground that marital sharing, although undoubtedly common, is not nearly as extensive as the advocates of the joint return allege. Finally, some commentators argue that all conceivable systems of family taxation are defective in some respects, but that the defects of systems employing separate returns are less serious than the defects of those utilizing joint returns. Joint return advocates readily concede that some types of joint return systems are seriously defective and properly subject to criticism, but they claim that a well-designed joint filing system can avoid such defects.

B. Types of Joint Return Systems

New York permits married taxpayers to elect to file jointly with

the principle was first articulated and defended in McIntyre & Oldman, Taxation of the Family in a Comprehensive and Simplified Income Tax, 90 Harv. L. Rev. 1573, 1592-94 (1977).

18 See Gann, supra note 9, at 6 (summarizing with apparent approval the argument that "marital status is irrelevant in determining what portion of the federal tax burden the individual should bear"); see also Munnell, The Couple Versus the Individual Under the Federal Personal Income Tax, in The Economics of Taxation 247, 266 (1980) (suggesting that the prospect of divorce makes it improper to assume that marriage has economic consequences).

17 See, e.g., McIntyre, supra note 10, at 472.

19 See, e.g., Dulude, Joint Taxation of Spouses—A Feminist View, Can. Tax'n, Winter 1979, at 8, 9. The merits of this allegation are examined infra notes 35-40 and accompanying text.


20 See McIntyre, supra note 10, at 477 (contending that marital income splitting is fair but that the least fair system of family taxation is one in which husbands and wives are required to combine their separate incomes and pay tax as if they were an individual). This Article tests the proposition that a well-designed joint filing system can avoid serious defects and criticism by setting forth and weighing the strengths and weaknesses of joint return and separate return systems. It concludes that the disadvantages of a separate return system, especially in the context of a state income tax, outweigh the advantages. See infra notes 181-82 and accompanying text.
their spouse.\textsuperscript{21} For most married persons, however, the option of filing a joint return is unattractive.\textsuperscript{22} Married persons filing jointly are required to pay tax on their \textit{combined incomes} according to the rate schedule used by individuals. If they file separate returns, however, the same rate schedule applies to their separate rather than their combined incomes, resulting in substantial tax savings whenever both spouses have substantial incomes.\textsuperscript{23} Thus, as a practical matter, New York is best characterized as a separate return jurisdiction despite its joint filing option.

One alternative to New York's elective joint return system is exemplified by the federal system in effect from 1948 to 1971. Prior to 1948, the federal government employed a marital filing system similar to New York's. That is, most married persons filed separate returns although they were granted an unattractive option to file jointly. In 1948, the federal government replaced that system with a

\begin{itemize}
  \item \textsuperscript{21} See infra note 48 and accompanying text.
  \item \textsuperscript{22} See infra notes 48-50 and accompanying text.
  \item \textsuperscript{23} See N.Y. Tax Law § 601(a) (McKinney 1975) (imposing tax under the rate schedule on “every individual, estate and trust”); id. § 611(b)(2) (treating, by implication, a husband and wife filing jointly as an individual for purposes of § 601). The provisions imposing tax on married persons filing jointly are not artfully drafted; § 601(a) imposes a tax on those filing jointly only by implication. Id. § 601(a).
  
  Consider, for example, a married couple in which each spouse has taxable income of $20,000. If this couple were to file a joint return in New York, the husband and wife would pay tax on $40,000 of taxable income at the same rate as would a single person with taxable income of $40,000. Because of New York's household credit, the married couple ultimately would pay less tax than an equal-income single person unless the single person qualified as a head of household. For a discussion of the household credit, see infra notes 111-13 and accompanying text. In computing taxable income, the married couple also would get one more personal exemption and a slightly higher minimum standard deduction than a single person. See infra notes 98 & 108.

  If the married couple in the above example were to file separate returns instead of joint returns, however, they would each pay tax on $20,000 of taxable income at the same rate as would a single person. Under the progressive rate schedule used by New York, the tax on $40,000 of taxable income will be greater than twice the tax on $20,000 of income. Accordingly, couples with two significant breadwinners should always file separate returns.

  For taxable year 1980, 1.4 million married persons filed their New York tax return jointly with their spouse and 3.2 million married persons filed separate New York returns. Of those filing jointly, about 80\% were couples in which only the husband had income, about 5\% were couples in which only the wife had income, and about 15\% were couples in which both spouses had some income. See Letter from Richard D. Pomp, Director of the Tax Study Commission, to Michael McIntyre, Professor of Law at Wayne State University (Apr. 20, 1984) [hereinafter cited as Pomp Letter]. Many taxpayers file jointly by mistake. See infra note 169.

  Married couples with two incomes, one of which is less than the $800 personal exemption, see infra note 92 and accompanying text, typically elect to file jointly. New York's system of an elective joint return in which a couple is taxed on its aggregate income is similar to the pre-1948 federal system as it applied to taxpayers residing in common law jurisdictions. Federal elective joint returns without splitting were sanctioned by the Revenue Act of 1918, ch. 18, § 223, 40 Stat. 1057, 1074 (1919). New York adopted the same rule in 1919. See supra note 2.
\end{itemize}
national system of joint filing with full income splitting. Under the income-splitting regime, husbands and wives aggregated their individual incomes and each spouse paid tax on one-half of the total marital income, using the same rate schedule as single persons. For example, marital partners with a combined income of $40,000 paid taxes equal to those paid by two single persons each having income of $20,000. The 1948 federal changes extended to married taxpayers residing in common law jurisdictions like New York a tax benefit already being enjoyed by taxpayers residing in the community property states. Married couples still were permitted to file separate returns, but except in unusual circumstances, they found it advantageous to file jointly. New York did not adopt this approach in 1948, and the state’s system fell out of step with the federal system.

As a result of federal tax changes enacted in 1969, and made effective in 1971, full income splitting was replaced by a third type of joint return system. Under the present federal system, married couples have their own specially-designed rate schedule. The taxes imposed on a married couple by that schedule are higher than the combined taxes imposed on two single persons, each with half the income of the couple, but they are somewhat lower than the taxes imposed on a single person with the same income as the couple.

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*See supra note 3.*

*See infra note 44. In 1951, the Congress enacted a special rate schedule for certain heads of households — generally single persons who maintain their own household and who claim certain persons as their dependents. See Revenue Act of 1951, ch. 521, § 301, 65 Stat. 452 (current version at I.R.C. § 1(b) (1982) (head of household schedule)). This rate schedule was enacted to provide single parents and other qualifying persons with a portion of the tax benefits that one-income married couples obtained from the Revenue Act of 1948, ch. 168, 82 Stat. 110. See infra notes 88-90 and accompanying text.*

*A married taxpayer residing in a community property state was permitted to file a separate return and report as his individual income one-half of the combined incomes of himself and his spouse. This result was sanctioned by the United States Supreme Court in Poe v. Seaborn, 282 U.S. 101 (1930).*

*Over 99% of married persons filing federal income tax returns file jointly. See INTERNAL REVENUE SERV., U.S. DEP’T OF THE TREASURY, PUB. NO. 1136, STATISTICS OF INCOME BULLETIN 48 (1984) (showing that for 1983, joint returns, representing two taxpayers per return, constituted 48.6% of returns filed, and that separate returns, representing one taxpayer per return, constituted only 0.7% of returns filed) [hereinafter cited as STATISTICS BULLETIN]. The percentage of married persons filing separately has decreased slightly since 1970, the last year of full income splitting.*


*See I.R.C. § 1(a) (1982) (schedule for married persons filing jointly).*

*The post-1971 rate schedules impose taxes on a couple with taxable income of $40,000 that are approximately equal to the aggregate taxes imposed on two single persons, one with taxable income of $32,000 (80% of $40,000) and the other with taxable income of $8,000 (20% of $40,000). The calculations in this example are computed in accordance with the 1983 federal
Also under the present federal system, married persons are not permitted to file separate returns unless they elect to employ a rate schedule that is significantly more graduated than the schedule used by single persons.  

Of the three joint return systems summarized above, only full income splitting is compatible with the two premises underlying the case for the joint return: first, that a husband and wife enjoy approximately the same standard of living, and second, that an individual's ability-to-pay is a function of the standard of living that individual actually enjoys. The pre-1948 federal system and the current New York joint return system are incompatible with these premises. Both systems tax marital partners electing to file jointly as if the two spouses were in fact one individual. That treatment was not designed to take account of the impact of marital sharing on a married person's standard of living.

The post-1971 federal system is also inconsistent with the premises that support a joint return. Instead of an equal sharing premise, its rate schedule incorporates the implicit assumption that, in the typical marital partnership, one spouse enjoys about eighty percent of the marital income and the other spouse enjoys only twenty percent. Congress designed that rate schedule in part to reflect the advantages of economies of scale that married persons allegedly enjoy over single persons. The major factor governing its design, however,

rate schedule, after adding back into income the $2,300 zero-bracket amount for single persons and the $3,400 zero-bracket amount for married couples. The example ignores possible differences in the deductions available to single and married persons because of their marital status. Since 1982, two-earner married couples have been able to claim a deduction equal to 10% of the earnings of the lower-income spouse. See infra notes 78-81 and accompanying text.


* The Staff of the Joint Committee on Internal Revenue Taxation offered the following explanation for the demise of full income splitting:

Reasons for Change. — Under prior law, the tax rates imposed on single persons were quite heavy relative to those imposed on married couples at the same income level; at some income levels a single person's tax liability was as much as 42.1 percent higher than the tax paid on a joint return with the same amount of taxable income. The Congress believed that some difference between the rate of tax paid by single persons and joint returns was appropriate to reflect the additional living expenses of married taxpayers but that the prior law differential of as much as 42 percent (the result of income splitting) could not be justified on this basis.

Staff of the Joint Comm. on Internal Revenue Taxation, 91st Cong., 2d Sess., General
was the congressional desire to reach an ad hoc compromise between the positions taken by advocates of the pre-1948 system of separate filing and by the advocates of full income splitting.\textsuperscript{34}

C. Estimating the Extent of Marital Income Sharing

Surveys conducted in the United States suggest that marital sharing is almost universal at low- and middle-income levels. At high-income levels, sharing is extensive, but less uniform.\textsuperscript{35} The empirical record supporting the proposition that married couples pool their separate incomes, however, is not definitive and probably never will be.\textsuperscript{36} Married couples cannot be expected to know the full extent of

\textit{Explanation of Tax Reform Act of 1969, at 222 (Comm. Print 1970).} The Staff of the Joint Committee did not attempt to explain why the tax on one single person should be compared to the tax on two married persons. Furthermore, it glossed over the fact that a single person was paying 42% more in taxes than two equal-income married persons with the same combined income. The language quoted above does suggest, however, that Congress intended some form of indirect tax on the economies of scale allegedly enjoyed by some married couples. No attempt was made to link the amount of relief granted to single persons to their enjoyment of less than average amounts of economies-of-scale benefits.

\textsuperscript{34} Advocates of tax relief for single persons typically compare the tax paid by a single person with the tax paid by a married couple having only one breadwinner. See Bittker, \textit{supra} note 11, at 1416-18. For a cryptic rendition of this argument by the Staff of the Joint Committee on Internal Revenue Taxation, see \textit{supra} note 33. In contrast, income splitting is grounded on the proposition that single persons should be compared for horizontal equity purposes to married persons who have equal incomes after marital sharing has taken place. For those who accept the theory of income splitting, the fact that a single person pays more in taxes than an equal-income married couple has no more relevance for tax design than the fact that a single person pays more in taxes than two single persons who live apart and who have the same aggregate income. In both cases, the complaint, if legitimate, concerns the excessive degree of progressivity of the rate structure, not the system of family taxation.

\textsuperscript{35} See, e.g., Thorson, \textit{An Analysis of the Sources of Continued Controversy over the Tax Treatment of Family Income}, 18 NAT'L TAX J. 113 (1965).

\textsuperscript{36} Two recent articles have challenged the widespread belief that marital partners pool their separate incomes to a substantial degree. Gann, \textit{supra} note 9, at 26 (stating that “hard data does not generally substantiate the assumption that married persons equally share their income” (footnote omitted)); Note, \textit{The Case for Mandatory Separate Filing by Married Persons}, 91 YALE L.J. 363, 372-73 (1981) (stating that “[t]he concept of income pooling, while widely accepted, remains without empirical support. . . . [M]odern studies of the family suggest that married persons retain the control and benefits of their personal incomes.” (footnotes omitted)). Gann does not cite studies indicating that marital partners do not share income, for there are no such studies. The “modern studies of the family” referred to in Note, \textit{supra}, at 372-73, are not surveys of family sharing practices. Instead, they are theoretical articles advancing the so-called exchange theory of marriage. Whatever the merits of these studies for other purposes, they are of little utility in resolving tax policy debates over the proper tax treatment of the family, for the concept of gain they employ in formulating the exchange theory includes such nonmarket benefits as companionship, sexual favors, and social status. The value of these benefits is determined by the idiosyncratic preferences of the alleged bargainer, not by the market. See McIntyre & Oldman, \textit{supra} note 15, at 1616-17 n.129 (questioning the relevance of
their sharing, since sharing may not be a calculated family policy and is almost never accompanied by careful record keeping.

A strong inference of marital pooling can be drawn from an examination of the components of a typical household budget. Because of the dynamics of family living, one should anticipate that amounts spent on food, shelter, medical care, and transportation will provide essentially equivalent benefits to both spouses. Those four items make up almost eighty-five percent of household expenditures, as measured by the market basket surveys that the United States Department of Labor conducts to compute the consumer price index. Both spouses are also likely to enjoy the other major items in that market basket — apparel, entertainment, personal care — in approximately equal amounts.37

The form in which marital partners hold their savings also provides some evidence of pooling. Many married couples probably hold a significant part of their liquid assets in joint savings accounts, although no data are available on the percentage of savings held in that form. Probably the most important components of savings, as distinguished from consumption, are the family home, accrued pension rights, and paid-up life insurance policies. Such assets typically provide signifi-

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37 See BUREAU OF LABOR STATISTICS, U.S. DEPT OF LABOR, CPI DETAILED REPORT, SEPTEMBER 1983, at 7:

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<td>4.2</td>
</tr>
<tr>
<td>Other Goods &amp; Services</td>
<td>5.0</td>
</tr>
<tr>
<td>Tobacco Products</td>
<td>1.4</td>
</tr>
<tr>
<td>Personal Care</td>
<td>1.9</td>
</tr>
<tr>
<td>Personal &amp; Educational Expenses</td>
<td>1.8</td>
</tr>
<tr>
<td>All Items</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Id. (figures rounded). For a similar breakdown of consumption expenditures for the entire United States economy, see BUREAU OF THE CENSUS, U.S. DEPT OF COMMERCE, 1982-83 STATISTICAL ABSTRACT OF THE UNITED STATES 422 (103d ed. 1982) (table no. 698) [hereinafter cited as STATISTICAL ABSTRACT].
cant benefits to both spouses, especially if their marriage is a durable one. In any event, the extent that marital savings are shared has modest significance for tax design, since total personal savings constitute only five to six percent of the total disposable income in the economy.

Although surveys of family sharing practices and information about the composition of the typical household budget buttress one's perception of marital sharing drawn from everyday experience, no amount of research is likely to put the issue to rest. The area of potential disagreement, however, is narrow. No one is likely to argue that marital partners typically enjoy wildly different standards of living. Because of the prevalence of marital pooling, it is not credible to claim that the separate income sources of marital partners are generally a better index of their standard of living than a fifty-fifty splitting formula.

Confusion over the extent of marital sharing can arise from a failure to distinguish between the sharing of the benefits financed by a couple's income and the sharing of control over the family purse strings. In a tax system that defines horizontal equity in terms of equality of benefits from income, the important issue is the degree to which benefits are shared. Anecdotal evidence indicating that some marital partners are keeping control over their separate incomes is not necessarily evidence against the marital pooling premise, since the marital partners might exercise control over their separate incomes in such a way that they both enjoy approximately the same standard of living.

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38 In harmonious marriages, there are no strong reasons to believe that income that is saved is less likely to be shared than income that is consumed. For marriages that end in divorce, the resulting property settlements provide some evidence of the extent to which savings are shared. Forty-one states, including New York, have adopted the doctrine of "equitable distribution," which rejects the concept that title to property should control the distribution of property upon divorce. New York law now requires the courts to take into account a wide range of factors in fashioning settlements, including the contribution of a spouse as homemaker to the material well-being of the family. See generally DiLeo & Model, A Survey of the Law of Property Disposition Upon Divorce in the Tristate Area, 56 St. John's L. Rev. 219 (1982); Freed & Foster, Family Law in the Fifty States: An Overview, 17 Fam. L.Q. 365 (1984). With the adoption of the "equitable distribution" rule in New York, it seems certain that each spouse will receive a significant share of marital property upon divorce in the absence of unusual circumstances.

39 See Statistical Abstract, supra note 37, at 420 (table no. 692).

40 Those who believe that marital transfers are best understood as bargained-for exchanges have asserted that sharing produces benefits for the giver that in principle ought to be subjected to taxation. See, e.g., Note, supra note 36, at 374-75 (arguing against joint returns on the theory that primary earners use their control over income to extract companionship, sexual favors, social status and other nonmarket benefits from their spouses). If spouses do get benefits from sharing that ought to be taken into account in measuring their taxable capacity, the
Assuming that equality of benefits is the agreed standard of horizontal equity, policymakers have a choice of two structurally distinct techniques for implementing that standard in a society where marital partners generally pool their separate incomes. Under the first approach, marital partners would combine their incomes, and divide the total by two. Each partner would then pay tax on their one-half share of the total according to the rate schedule applicable to unmarried persons. In such a system, the individual, whether married or unmarried, is the formal taxpayer.

Under the second approach, a married couple would be taxed as a unit under a rate schedule having tax brackets twice as wide as those contained in the rate schedule applicable to unmarried persons. The single individual and the married couple both would be formal taxable units. While this approach is functionally equivalent to the first, it has a significant psychological disadvantage, for it is likely to suggest to some taxpayers that married couples are being taxed at a lower effective rate than single persons. In fact, the lower nominal

proper response would be an adjustment of the tax base, not a rate adjustment. Of course most commentators would be properly embarrassed to propose an explicit tax on the monetary value of nonmarket marital favors.

1 A single person, for example, presumed to enjoy $20,000 of income would pay tax at the same rate as a married person presumed to enjoy $20,000 of income.

2 If, for example, single persons were taxed at a rate of 5% on their first $10,000 of income and at 10% on income over $10,000, then married couples would be taxed at the rate of 5% on the first $20,000 of income and at 10% thereafter.

3 Assume, for example, that a married couple has aggregate income of $40,000. Under the illustrative married couple’s rate schedule provided supra note 42, the couple would pay a tax of $3,000 ($20,000 x .05 + $20,000 x .10). The tax attributable to each spouse, therefore, would be $1,500. If, instead of being taxed as a couple, each spouse was taxed as an individual under the unmarried person’s rate schedule, then each would pay tax of $1,500 ($10,000 x .05 + $10,000 x .10). A single person with income of $20,000 would also pay a tax of $1,500; two single persons, each with income of $20,000, would pay a total of $3,000 in taxes.

4 When Congress enacted full income splitting in 1948, see supra note 3, it apparently intended to sanction the first of the two approaches discussed supra note 41 and accompanying text. The statutory language, however, is ambiguous. Section 12(d) of the 1948 Internal Revenue Code, as amended, stated:

Tax in Case of Joint Return. — In the case of a joint return of husband and wife under section 51(b) [current version at I.R.C. § 6013 (1982)], the combined normal tax and surtax under section 11 and subsection (b) of this section shall be twice the combined normal tax and surtax that would be determined if net income and the applicable credits against net income provided by section 25 were reduced by one-half.

I.R.C. § 12(d) (1948) (amended 1954 & repealed 1969). According to this statutory language, marital partners filing jointly were required to compute their tax as if they were two single persons, each with one-half of the couple’s combined income. Although the tax is formally imposed on the couple, the statute did not establish a separate rate schedule for married persons filing jointly. The tax services, however, immediately constructed one for their customers. See, e.g., 1948-1949 Combined Effective Normal Tax and Surtax Tables, 1 STAND. FED. TAX REP. (CCH) 10 (1949).
rates applicable to couples under the second approach exactly offset the disadvantage that marital partners suffer from paying tax as a couple on their combined incomes.

II. REVIEW OF NEW YORK LAW

New York has adopted a wide variety of mechanisms that adjust tax burdens because of the family circumstances of taxpayers. This section of the Article examines those mechanisms and provides a detailed analysis of the implications of New York’s choice of a “separate filing” rule for taxing married persons. It also examines the personal and dependency exemptions provided under New York law and discusses some of the tax planning opportunities they provide. It then explains the mechanisms for granting tax relief to low-income households and presents a brief summary of the New York allowances for child care and higher education tuition.

A. Taxation of Marital Partners, Former Spouses, and Single Parents

This subsection has three subparts. Subpart 1 provides a detailed analysis of New York’s tax treatment of marital partners, with emphasis on the substantial opportunities for informal income splitting that it offers. It then explains briefly the impact on New York law of the recently adopted federal deduction for so-called secondary earners. Subpart 2 illustrates how former spouses can split income through the deduction for alimony payments, and subpart 3 explains how one-parent families fare under New York law.

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The House Report on the Revenue Act of 1948 states that “[a]lthough there are two taxpayers on a joint return, there is only one net income.” H.R. Rep. No. 1274, 80th Cong., 2d Sess. 47, reprinted in 1948 U.S. Code Cong. & Ad. News 1258, 1280. This two-taxpayer perspective suggests that Congress intended the joint filing rule to be a technique for determining the individual incomes of the spouses. The ambiguity of the statutory language suggests, however, that Congress was concerned with the practical consequences of its income splitting rule and not with the theory of taxation that underlay it.
1. Taxation of Married Couples

   a. Income Attribution Under New York's Separate Filing Rule

   In sharp contrast to the federal system, which uses different rate schedules for single persons, married couples, and heads of household, New York employs the same rate schedule for all taxpayers. The marginal rates on the New York schedule range from two percent on the first $1,000 of taxable income to fourteen percent on taxable income over $23,000. The marginal rate on personal service income is capped at ten percent for taxable income in excess of $17,000.

   Married couples filing joint federal returns (or couples not required to file federal returns) may file jointly in New York as long as both spouses are New York residents or both elect to be taxed as residents. Joint filing is generally disadvantageous for two-income married couples, but under limited circumstances it can provide a modest advantage to certain of these couples. When both spouses have income sources greater than the amount of their personal exemptions, they almost always may save taxes by electing to file separately. Indeed, the majority of married taxpayers do file separately.

   New York uses an individual's federal adjusted gross income as the starting point in defining New York taxable income. Consequently,

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48 Id. § 603-A(a). Personal service income includes wages, pensions, professional fees, and other compensation for services rendered, including gains from sale of assets created by the taxpayer. Id. § 603-A(b)(1).
49 Id. § 611(b) (McKinney 1975).
50 See infra note 101 and accompanying text.
51 See supra note 23. The tax savings can be substantial. A two-earner married couple, for example, each spouse having wages of $19,100, saves $840 by filing separately. Married persons itemizing their personal deductions rather than claiming the zero-bracket amount (standard deduction) receive a savings in New York taxes, but that savings will be offset in part by the higher federal personal income taxes that result from their smaller deduction for New York income taxes.

   For administrative convenience, spouses who file separate returns in New York are required to report their individual income sources and tax liabilities on a single tax declaration — Form IT-201. The joint use of a single form, however, is for administrative purposes only and should not be confused with a joint return, the characteristic feature of which is the aggregation of the gross incomes and deductions of the husband and wife.

   52 See N.Y. Tax Law § 612(a) (McKinney 1975) (defining New York adjusted gross income as federal adjusted gross income with adjustments); id. § 611 (defining New York taxable income
New York incorporates the federal rules for attributing or assigning specific items of gross income (dividends, wages, rents, etc.) to particular taxpayers. In addition, New York has implicitly adopted the federal attribution rules for those deductions which reduce gross income to adjusted gross income.

The federal rules for attributing or assigning items of gross income to particular taxpayers can be summarized as follows. The rule for earned income is that it is taxable to the wage earner, a rule that generates few administrative problems.\textsuperscript{62} The rules regarding property income are more complicated and involve ambiguities and uncertainties that create the potential for manipulation and unintended tax savings.\textsuperscript{63} Property income is generally taxable to the person holding legal title to the income-producing property, but this rule is subject to many qualifications. The apparent purpose of the legal-title rule is to tax property income to the person who controls that income, notwithstanding that nominal legal title may be a poor proxy for control.\textsuperscript{64}

Sophisticated legal devices abound for transferring legal title to a lower-income family member without surrendering total control over the income.\textsuperscript{65} Only occasionally has Congress attempted to fashion rules dealing with these tax avoidance situations.\textsuperscript{66} Whatever rules exist have developed over the years through administrative and judicial action, with congressional intervention occurring primarily in the trust area.\textsuperscript{67}

Since the adoption of income splitting in 1948, the overwhelming majority of married persons have computed their federal tax by aggregating their income with that of their spouse.\textsuperscript{68} Accordingly, Congress and the IRS have not had to worry whether the husband or the wife is the proper taxpayer on particular items of property income, because in any case, their individual incomes are added together. Only rarely do the joint incomes of spouses need to be separated for federal filing purposes. The majority of post-1948 federal cases on the income attribution question are concerned primarily with situations


\textsuperscript{63} For a description of the rules governing the attribution of property income, see B. Bittker, supra note 52, ¶ 30.3.

\textsuperscript{64} See McIntyre, supra note 10, at 474-76.

\textsuperscript{65} See B. Bittker, supra note 52, ¶ 30.3.

\textsuperscript{66} Id.

\textsuperscript{67} Id. ¶ 33.

\textsuperscript{68} See supra note 27.
that are unrelated to the taxation of married couples, such as, for example, those involving corporations and partnerships. Such fact patterns have provided the courts and the IRS with little reason to be sensitive to the income attribution problems faced by New York.

By not following the federal system's use of joint returns, New York has shouldered the responsibility for administering an important part of its income tax — the determination of the individual incomes of married taxpayers — without federal assistance. The New York State Legislature could have discharged that responsibility by providing in the tax law a detailed set of family attribution rules to fill the federal void. Instead, the state tax law simply states that "if husband and wife determine their federal income tax on a joint return but determine their New York income taxes separately, they shall determine their New York adjusted gross incomes separately as if their federal adjusted gross incomes had been determined separately." The effect of this provision is to incorporate into New York law all the uncertainties and petty distinctions that characterized the federal system of marital attribution rules prior to 1948. They are incorporated, however, without the assistance of the IRS and of the federal courts in resolving fresh disputes.

The uncertainties of the pre-1948 federal attribution rules are difficult to overstate. Joint savings accounts provide one example of the problems encountered when determining whom to tax on income arising from property in which both spouses have ownership rights. An IRS revenue ruling states that for federal income tax purposes, if two or more persons hold a savings account as joint tenants, the interest earned is owned by each person to the extent that each is entitled under local law to a share of such income. For New York spouses, therefore, the determination of the proper taxpayer on interest from a joint savings account turns first on whether the husband and wife hold the account as joint tenants, and second, on the rights of joint tenants under New York law.

New York's banking law establishes a rebuttable presumption that the depositor to a two-name joint account intends a gift of one-half

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**See, e.g.,** United States v. Basye, 410 U.S. 441 (1973) (holding that partners providing medical services to a company are taxable currently on amounts placed in trust by the company to fund retirement pensions for the partners); Commissioner v. First Sec. Bank, 405 U.S. 394 (1972) (holding that the bank was not taxable on income arising from its arrangement of the sale of credit life insurance by its captive insurance subsidiary because the bank was prohibited by law from engaging in the insurance business).


**Rev. Rul. 76-97, 1976-1 C.B. 15-16.**
of the deposit to the other tenant.\textsuperscript{62} A withdrawal from a joint account by one joint tenant, however, does not change the ownership rights originally created by the deposit.\textsuperscript{63} Withdrawals from joint accounts are commonplace, and clear intent of the joint tenants to re-establish equal ownership by gift is rarely available. As a practical matter, therefore, the rights of joint tenants in a savings account are difficult to determine.

The New York State Tax Department has issued a regulation that seeks to establish a presumption that joint accounts are owned in equal parts by the joint tenants, without regard to withdrawals made after the account was established.\textsuperscript{64} Married taxpayers prepared to challenge or rebut the presumption can divide their bank interest income between themselves and their spouses and report it on their separate state returns in the most advantageous manner. Because the IRS has no reason to care about the New York property rights of married persons filing joint federal returns, neither a married couple's federal joint return nor any other information obtained by the IRS is likely to prove useful to the New York State Tax Depart-

\begin{flushright}
\textsuperscript{62} See N.Y. Banking Law \textsection{675(a)} (McKinny 1971).
\textsuperscript{63} Id. If, for example, H and W open a joint account with a deposit of $100 and H withdraws $25 for any reason, W would no longer be the owner of one-half the joint account, but instead would own two-thirds, since W's original claim to $50 is not reduced by H's withdrawal.
\textsuperscript{64} See N.Y. Admin. Code tit. 20, \textsection{116.6(c)} (1982). The regulation issued by the Tax Department provides:
\end{flushright}

A husband and wife who file a joint Federal income tax return and separate New York State personal income tax returns on one return must each report his or her share of income from jointly owned real estate, stocks, bonds, bank accounts and other property, in the same manner as if their Federal adjusted gross incomes had been determined separately. The rules for determining the manner of reporting this income depend upon the nature of the ownership interests and, in general, may be summarized as follows:

(1) Joint tenants. A husband and wife owning property as joint tenants with the right of survivorship — a common example of which is a joint bank account — should each report one-half of the income from the property when separate New York State personal income tax returns are filed.

(2) Tenants by the entirety. A husband and wife should each report on separate New York State personal income tax returns one-half of the income from real estate held by them as tenants by entirety.

(3) Tenants in common. Income from property held by husband and wife as tenants in common is reportable by them in proportion to their legal ownership interests in the property, which will generally be equivalent to their ratably contributions to the investment in such property.

\textit{Id.} Although the regulation suggests that one-half of the interest from a joint bank account should generally be reported by each spouse, legal basis for that regulation is weak. In effect, the regulation seeks to solve the problem of determining the proper taxpayer on jointly owned property by adopting a presumption of income splitting. This “solution” is sensible, but it is more consistent with the principle underlying the federal joint return than with the principle implicit in the New York tax law.
ment in determining how married persons filing separate state returns should have been reporting their bank interest.

Under New York law, income produced by property held by marital partners either as tenants in common or as tenants by the entirety is taxable to the spouses in proportion to their respective fractional interest in the income-producing property.66 The State Tax Department generally accepts without challenge the property income attribution positions taken by married persons on their New York tax returns.66 As a result, most marital partners have only occasional opportunities to shift wage income to the spouse in a lower marginal tax bracket, although they can routinely shift property income.

For New York purposes, similar attribution problems arise in the allocation of capital losses between spouses. It is unrealistic to expect the New York State Tax Department to have the capacity to determine the true ownership of the property generating the losses, and again, no assistance is forthcoming from the IRS.

The shifting of business-related deductions is more difficult to accomplish than the shifting of losses and property income. To shift business deductions, both spouses must be engaged in business, and the expenses to be shifted must at least arguably relate to the business of the higher-taxed spouse.67 Even if these conditions are satisfied, however, it is difficult for the Tax Department to police the allocation of business-related deductions.

State tax law allows married persons to allocate their itemized personal deductions or their standard deduction between themselves and their spouse in any manner they desire.68 Thus, married persons are free to manipulate those deductions to minimize their taxes. By enacting such a rule, New York has implicitly recognized that it cannot develop and administer a set of principled rules for determining which spouse should properly claim which deductions.

By using separate returns, New York provides taxpayers with an incentive to employ all of the income shifting mechanisms that have been developed through the years. For spouses willing to adjust their ownership interest in assets, these mechanisms permit the full splitting of investment income. Earned income cannot be split so easily, although the establishment of a family partnership and the making of an intrafamily loan are techniques that can have the effect of split-

66 Id. See supra note 64.
66 See Pomp Letter, supra note 23.
67 See B. Britker, supra note 52, ¶ 30.2(7), at 30-12 to 30-13.
68 See N.Y. Tax Law § 615(b) (McKinney 1975).
ting earned income. 69

The maximum New York tax savings that can arise under current law from the use of income shifting devices is $1,440. This tax savings results when one spouse is taxable at the fourteen percent marginal tax rate and the other spouse has no taxable income prior to the use of the income shifting devices. 70 If a federal joint return is filed and the couple claims the federal standard deduction (zero-bracket amount), no offsetting increase in federal taxes will result from the use of these mechanisms to minimize state taxes, many of which are inexpensive to implement. If the marital partners itemize their personal deductions, however, their reduced New York income taxes will increase their federal income taxes, but by less than the reduction in their state taxes. Use of income shifting techniques would not lower a couple's state tax burden under a joint return with full income splitting because a couple's income would already be assumed to be split in the most advantageous manner. 71

No attempt will be made here to enumerate the myriad types of income shifting devices available to married couples. For illustrative purposes, three of the best known devices — interspousal gifts, interspousal loans, and family partnerships — will be discussed briefly.

Couples can reduce their New York taxes by having the spouse in the higher tax bracket make a gift of income-generating property to the spouse in the lower tax bracket. 72 In this manner, the income previously reported by the higher-taxed spouse would be reported by the

69 See infra notes 72-77 and accompanying text (briefly summarizing income shifting techniques).

70 New York's top marginal rate of 14% is reached at taxable income of $23,000. See N.Y. Tax Law § 602(d) (McKinney Supp. 1984-1985). The maximum tax savings from marital income splitting results when a taxpayer succeeds in getting $23,000 of income otherwise taxed at 14% to be taxed at the bracket rates below 14%. The taxpayer's savings equals $1,440, computed by subtracting the tax on the first $23,000 of income according to the rate schedule ($1,780) from the tax on $23,000 at the rate of 14% ($3,220).

71 New York married couples who split their incomes for tax purposes by the use of "self-help" income shifting mechanisms obtain a significantly more favorable result than they would achieve from a general splitting rule applicable to all married taxpayers. Under a general splitting rule, much of the tax savings obtained by taxpayers from income shifting would be offset by the somewhat higher tax rates that would be required to preserve state revenues at pre-reform levels. Under New York's self-help method of income splitting, however, some married taxpayers, particularly the large group of average wage earners, cannot shift their incomes optimally. Because those taxpayers pay more tax than they would under a full income splitting regime, the taxpayers who take advantage of splitting opportunities are able to pay less tax.

72 Gifts made from one spouse to the other are excluded from both the federal and the New York income tax bases. See I.R.C. § 102 (1982) (excluding gifts and inheritances from gross income); N.Y. Tax Law § 612(a) (McKinney 1975) (defining adjusted gross income for the New York tax in terms of federal adjusted gross income).
lower-taxed spouse. Advocates of separate returns who believe that an outright gift produces tax-significant changes in the material well-being of the donor and the donee should not be offended by this type of income shifting through intrafamily gifts.73 Common experience, however, suggests that transfers of title by members of stable marital partnerships frequently will be viewed by the parties as mere changes in form.74

Under New York and federal law, debtors who itemize their personal expenses can deduct interest paid on a personal loan.75 This rule permits couples to split their income for New York purposes by having the higher-bracket spouse borrow money from the lower-bracket spouse.76

In a partnership, each partner is taxed on his or her share of the partnership income.77 If capital is a material income-producing factor of the partnership, the owner-operator of the business can shift some of the partnership income to his spouse by making a gift to the spouse of an interest in the partnership. The donee-spouse will then report income that was previously being reported by the donor-spouse, resulting in a state tax savings if the donee-spouse is in a lower tax bracket. Of course, the donor-spouse must receive reasona-

73 Many advocates of individual filing, however, count as a defect the income shifting opportunities that their proposed system would present to married couples. See, e.g., Brazer, supra note 9, at 242-43 (expressing some concern that the income shifting opportunities of separate filing favor taxpayers with investment income over wage earners but concluding that all the remedies to that problem are unattractive).

74 Donors who fear that a gift may have substantive effects can hedge by making the transfer conditional upon the continuation of the marriage. For example, one spouse could make a gift to the other of $10,000 of property, with the stipulation that in the event of divorce, the $10,000 would be set off against any rights to a property settlement. Such a transfer is almost certainly valid for income shifting purposes, but it makes no real change in the most important property right that a spouse possesses vis-a-vis the other spouse with respect to marital property. Another way a donor can hedge is by structuring a gift in a way that guarantees that he, the donor, does not surrender any meaningful elements of control. For example, one spouse might make a gift to the other of nonvoting stock in the donor's corporation. The corporation might have the right to redeem the stock, which could be exercised in case of divorce.

75 See I.R.C. § 163(a) (1982) (granting a deduction for "all interest paid or accrued within the taxable year on indebtedness"); N.Y. Tax Law § 615(a) (McKinney 1975) (making federal itemized deductions the starting point in computing New York itemized deductions).

76 Assume, for example, that one spouse has earned income of $20,000 and the other has earned income of only $10,000. In order to equalize their incomes and thereby lower their taxes, the $20,000 spouse may borrow money from the $10,000 spouse and then pay the creditor spouse interest of $5,000. The interest payment of $5,000 would reduce the debtor spouse's income to $15,000 ($20,000 - $5,000) and increase the creditor spouse's income to $15,000 ($10,000 + $5,000), producing an even split of income.

ble compensation from the partnership for any services he may perform for it.

b. The Federal Deduction for Two-Earner Married Couples

For federal purposes, married couples filing joint returns can generally deduct ten percent of the earned income of the spouse with the lower income, up to a maximum deduction of $3,000.\textsuperscript{78} Because this deduction is not available to married persons filing separate federal returns,\textsuperscript{79} New York spouses cannot take the deduction for state purposes unless they file joint New York returns.\textsuperscript{80} Thus, the large number of two-earner married couples who do not elect to file jointly in New York,\textsuperscript{81} are not entitled to claim this federal deduction on their state return.

2. Taxation of Divorced and Separated Persons

The Internal Revenue Code permits a taxpayer making alimony payments to a former spouse to exclude from his or her adjusted gross income the amount of those payments.\textsuperscript{82} The former spouse, in turn, is taxable on that amount.\textsuperscript{83} This same pattern applies to separate support payments made under a written separation agreement or a court decree.\textsuperscript{84} New York incorporates these rules by carrying over from federal law the definition of adjusted gross income.\textsuperscript{85}

Because of the alimony and separate support payment deductions, separated and divorced individuals can split their combined incomes under New York law, while spouses living together may not split their incomes.\textsuperscript{86} The deductions for alimony and separate support are

\textsuperscript{78} See I.R.C. § 62(16) (1982) (allowing the deduction granted under § 221 of the Internal Revenue Code to reduce adjusted gross income); id. § 221 (granting a deduction for 10% of the first $30,000 of income of the lower-income spouse).

\textsuperscript{79} Id. § 221(a).

\textsuperscript{80} See N.Y. Tax Law § 612(f) (McKinney Supp. 1984-1985) (requiring husbands and wives who file federal joint returns to compute their New York income tax liability "as if their federal adjusted gross income had been determined separately").

\textsuperscript{81} See supra note 27.

\textsuperscript{82} See I.R.C. §§ 62(13), 215 (1982).

\textsuperscript{83} Id. § 71.

\textsuperscript{84} Id. § 71(a)(2), (3).

\textsuperscript{85} See N.Y. Tax Law § 611(a) (McKinney 1975).

\textsuperscript{86} Assume, for example, that H and W are married, that H has wage income of $20,000, and that W has no separate income sources. Under current New York law, H is taxable on the $20,000, after allowances for deductions and personal exemptions. If, however, H and W ob-
the only significant exceptions to the general rule of New York tax law that wage income is taxable to the wage earner and property income is taxable to the person with legal title.

The current New York and federal treatment of alimony and separate support payments is reasonable and has broad support from the public and from most commentators, even among those who generally favor an individual filing system of separate returns. The rule, nevertheless, is a curious one for a tax system, like New York’s, that prohibits marital partners from splitting their separate incomes, since the rationale underlying the alimony rule — to tax the person who ultimately benefits from the income — is identical to the rationale for marital income splitting.

3. Taxation of One-Parent Families

The Internal Revenue Code permits certain individuals to compute their tax under the head of household rate schedule. Taxpayers generally qualify for that schedule if they are single and maintain a household for themselves and one or more dependents. The rate brackets of the head of household schedule are somewhat narrower than the brackets under the rate schedule applicable to married couples filing jointly, but they are wider than the brackets of the single persons’ rate schedule. The technique of providing benefits to one-parent families through a special rate schedule has little support.

tained a divorce and H entered into a separate support agreement with W and began making payments of $10,000 to W that qualified as alimony under federal standards, then H and W would each be taxable on $10,000 of income. Congress acted in 1984 to make the “divorce bonus” less attractive by denying the alimony deduction to former spouses who continue to live together. See Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 422, 98 Stat. 494, 795 (to be codified at I.R.C. § 71(b)(1)(C)).


Advocates of “marriage neutrality” generally omit from their analysis any discussion of income splitting between former spouses. See, e.g., Brazer, supra note 9; Gann, supra note 9; Munnell, supra note 16. But see Wenig, Marital Status and Taxes, in UNMARRIED COUPLES AND THE LAW § 5.11 (G. Douthwaite ed. 1979). There may be reasons for favoring individual filing for married taxpayers and income splitting for former spouses through the alimony deduction, but there are no principled arguments for marriage neutrality that are not also arguments against the alimony deduction. See McIntyre, supra note 10, at 473.


* See I.R.C. § 2(b)(1) (1982). Taxpayers who claim their parents as dependents qualify for the head of household schedule even if their parents live separately. Id. § 2(b)(1)(B).
among commentators.\textsuperscript{90}

New York offers one-parent families no benefit comparable to the federal heads of household schedule. It does offer a tax credit for the head of a household, but that credit is available to all taxpayers maintaining a household, including married persons and single persons without dependents.\textsuperscript{91}

\subsection*{B. Personal and Dependency Exemptions}

New York grants personal exemptions of $800 to its resident taxpayers (and taxpayers electing to be taxed as residents) for themselves and for their dependents under a modified version of the rules of the federal income tax.\textsuperscript{92} Under the federal rules, individuals are entitled to a personal exemption for themselves and for each of their dependents.\textsuperscript{93} Additional exemptions may be taken by taxpayers who are blind or at least sixty-five years old.\textsuperscript{94} Because spouses filing jointly are each considered taxpayers (even if one spouse has no independent income), they are each entitled to a personal exemption.\textsuperscript{95} Married persons filing separately may claim an exemption for their spouse (including the additional exemptions for persons who are blind or at least 65 years old) if the spouse has no gross income for the year and is not the dependent of another taxpayer.\textsuperscript{96} The purpose of this rule is to ensure that married persons filing separately receive an exemption for a truly dependent spouse without creating opportunities for the dependent spouse or the parents of the dependent spouse to claim the same exemption.\textsuperscript{97}

\textsuperscript{90} See, e.g., McIntyre & Oldman, supra note 15, at 1601-02, 1630 (showing that the benefits of the head of household schedule bear no systematic relationship to need and, because of the absence of a consolidation requirement, that they cannot be defended on income splitting grounds). See also Coven, supra note 10, at 1537 n.52 (characterizing the one-parent relief as "an arbitrary rate reduction devoid of factual support").

\textsuperscript{91} See infra notes 111-13 and accompanying text.

\textsuperscript{92} See N.Y. Tax Law § 616 (McKinney Supp. 1984-1985). Nonresident taxpayers are entitled to the same number of exemptions as are residents, but the amount of the exemptions may be reduced because nonresidents must forfeit that portion of the exemption which is allocable to income sources arising outside of New York. Id. § 636 (McKinney 1975).

\textsuperscript{93} See I.R.C. § 151(b), (e) (1982).

\textsuperscript{94} Id. § 151(c), (d).

\textsuperscript{95} See Treas. Reg. § 1.151-1(b) (1972).

\textsuperscript{96} See I.R.C. § 151(b) (1982) (limiting the exemption for a spouse to the case where the spouse has no separate income and is not claimed as a dependent by any other taxpayer); id. § 151(c)(2) (extending to spouses the additional exemption for being 65 or older); id. § 151(d)(2) (extending to spouses the additional exemption for being blind).

\textsuperscript{97} See Treas. Reg. § 1.151-1(b) (1972).
The federal rules grant the personal and the dependency exemptions to married couples filing jointly without attributing these exemptions to a particular spouse.\textsuperscript{98} Spouses who file separate New York returns need to know what exemptions they are entitled to claim. The state's rule is that spouses who file separate returns in New York can claim each federal exemption that they could have claimed on a federal return if they had filed separate federal returns.\textsuperscript{99}

The latter rule presents some interesting tax planning opportunities, although it is unclear how many taxpayers take advantage of them. In the case of the dependency exemption, spouses can arrange or characterize their affairs so that the spouse in the higher tax bracket\textsuperscript{100} claims all of the available dependency exemptions. For example, the spouse wishing to claim the dependency exemption could characterize payments made to the dependent as coming from that spouse's own funds and not those of the other spouse. As a practical matter, this potential abuse of the dependency exemption cannot be policed, leaving taxpayers free to minimize their state income taxes by having the higher- bracket spouse claim the dependency exemption.

Tax planning around the personal exemption is somewhat complex. Each of the following four situations can have a different set of New York tax consequences: (1) both spouses have federal and New York gross income; (2) one spouse has New York gross income but no federal gross income; (3) one spouse has no federal gross income and no New York gross income; and (4) one spouse has federal gross income but no New York gross income.

When both husband and wife have income sources under federal and New York law (situation 1), they should elect separate filing in New York if the lower-income spouse has income at least equal to the amount of that spouse's exemption. If the lower-income spouse's New York income is less than the exemptions he or she can claim, the marital partners should elect to file jointly. An exception occurs when the lower-income spouse has no gross income under federal law but has some New York gross income (situation 2). Under this condition, which could occur if one spouse has only interest income from bonds issued by other states, the spouses should file separately. The higher-

\textsuperscript{98} Id. § 1.151-1(b), -2(a).
\textsuperscript{100} Because of the 10% cap on personal service income, the spouse in the higher tax bracket is not necessarily the spouse having the higher income. For an example of a situation in which the lower-income spouse is in the higher marginal tax bracket, see infra note 167.
income spouse then can claim both an individual and a spousal exemption, and the lower-income spouse can claim an individual exemption — an unintended, but apparently legitimate double-dip.\footnote{As an illustration, consider H and W, a married couple. H has wages of \$20,000 and W receives \$800 of interest income from a Connecticut bond, tax-exempt under federal law, see I.R.C. \S 103 (1982), but taxable in New York, see N.Y. Tax Law \S 612(b)(1) (McKinney 1975). By filing jointly in New York, H and W would claim two exemptions of \$800. By filing separately, however, H could claim both a personal exemption of \$800 and a dependency exemption of \$800 because under federal law H would be entitled to claim an exemption for W who has no federal gross income. Under state law, W could also claim a personal exemption of \$800 if a state separate return were filed, resulting in the couple claiming three personal exemptions. W would be able to claim a personal exemption for state purposes because under federal law W would be entitled to a personal exemption, notwithstanding that the exemption would be worthless because W has no federal gross income.}

Marital partners can elect to file jointly or separately without any difference in their New York tax liability when one spouse has no New York income and no federal gross income (situation 3). If they file separately, the spouse having the income can claim a personal exemption for the spouse having no income; if they file jointly, each may claim their own personal exemption. In both cases, the couple receives two personal exemptions.

When one spouse has no New York income but has some federal gross income (situation 4), the marital partners must elect to file jointly to preserve the benefit of the personal exemption of the spouse having no New York income. If they file separately, the spouse with New York income cannot claim a personal exemption for the other spouse.

**C. Low-Income Relief for Households**

New York employs three tax techniques for limiting the tax liability of low-income taxpayers. First, it provides a low-income exemption that excludes from taxation all unattached individuals (i.e., unmarried taxpayers who are not heads of households or surviving spouses) whose New York adjusted gross income is \$2,500 or less and all heads of household whose New York adjusted gross income does not exceed \$5,000.\footnote{See N.Y. Tax Law \S 601(a)(2)(A) (McKinney 1975) (exempting from tax individuals "whose New York adjusted gross income for the taxable year is two thousand five hundred dollars or less, provided such individual is not married nor the head of a household nor a surviving spouse"); id. \S 601(a)(2)(B), (C) (granting an exemption to heads of household, surviving spouses, and married persons whose New York adjusted gross income for the year does not exceed \$5,000).} Taxpayers whose New York adjusted gross income is one dollar above these exempt amounts receive no benefit
from the exemption. The $5,000 exemption applies to low-income married couples whether they file jointly or separately; to determine their eligibility for the $5,000 exemption, spouses filing separate New York returns must aggregate their separate incomes. Because personal and dependency exemptions are not part of the definition of New York adjusted gross income, they are irrelevant in determining a taxpayer's eligibility for the low-income exemption.

A second mechanism, which dovetails with the low-income exemption, is the minimum standard deduction of $1,500 for unattached individuals and $2,000 for heads of household, surviving spouses, and married couples. Married couples filing separately may divide the $2,000 minimum standard deduction between themselves however they want. This minimum standard deduction provides a floor to New York's percentage standard deduction, which is equal to seventeen percent of New York adjusted gross income. The cap on the percentage standard deduction is $2,500 for both single and married persons. Marital partners filing separate returns can also divide their aggregate percentage standard deduction between themselves in any manner whatsoever.

103 See N.Y. Tax Law § 601(a)(2) (McKinney 1975) (excluding from definition of persons subject to tax those with incomes below the threshold amounts).
104 Id. § 601(a)(2)(C).
105 Under federal law, the personal exemptions are deducted from adjusted gross income to obtain taxable income. See I.R.C. § 63(b)(1)(B) (1982). New York has adopted the same pattern. Pursuant to N.Y. Tax Law § 612(a) (McKinney 1975), federal adjusted income is the starting point in computing New York adjusted gross income. The New York personal exemptions are deductible from New York adjusted gross income to obtain New York taxable income. Id. § 611(a).
106 See N.Y. Tax Law § 614(c)(1) (McKinney Supp. 1984-1985) (granting a minimum standard deduction of $1,500 to unattached individuals); id. § 614(c)(2) (granting a minimum standard deduction of $2,000 to married persons filing jointly, heads of household, and surviving spouses); id. § 614(c)(3) (granting a minimum standard deduction of $2,000 to married persons filing separately).
107 Id. § 614(c)(3).
108 Id. § 614(a).
109 Id.
110 See id. § 614(b). This system of a percentage standard deduction with a cap and a floor follows the federal approach used from 1964 to 1977. See Revenue Act of 1964, Pub. L. No. 88-272, § 112(a), 78 Stat. 19, 23 (repealed 1977) (providing a low-income allowance of $300 for single persons without dependents and $400 for married persons without dependents filing jointly). The low-income allowance was increased substantially in the 1970's. By 1976, it was $1,700 for single persons and $2,100 for married persons filing jointly. See Tax Reform Act of 1976, Pub. L. No. 94-455, § 401(b)(1), 90 Stat. 1525, 1556 (repealed 1977).

In an attempt to simplify federal tax law for average taxpayers, Congress eliminated the percentage standard deduction in 1977 and converted the old caps on the standard deduction into a fixed standard deduction. See Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, § 102, 91 Stat. 126, 135 (codified as amended at I.R.C. § 63(d) (1982)). The fixed stan-
The third of the three mechanisms for low-income relief is a vanishing, nonrefundable household credit that starts at $70 for households whose aggregate household New York adjusted gross income and aggregate New York minimum taxable income is less than $5,000. The household credit vanishes incrementally as the income measure defined above increases; it is eliminated entirely for those households with aggregate incomes over $25,000.

D. Allowances for Family Expenses

1. Child and Other Dependent Care Credit

New York provides a nonrefundable tax credit for certain child-care expenses incurred by one-parent households or by married couples with both spouses working outside the home, attending school, or some combination of the two. The allowable credit generally is twenty percent of the credit allowed under the federal income tax. For married persons filing joint federal returns and separate New York returns, the credit must be taken by the spouse with the lower New York taxable income.

Under the federal child-care provision, taxpayers can claim a credit of up to $2,400 per child or dependent and $4,800 overall. The credit is limited to thirty percent of qualifying expenses for taxpayers with adjusted gross income of $10,000 or less. The percentage of costs qualifying for the credit is reduced (but not below twenty percent) by

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111 A "household" for purposes of the credit means a married couple, a head of household, a surviving spouse, or an unattached individual not taken as a dependent by any taxpayer. N.Y. Tax Law § 606(b)(3)(B) (McKinney Supp. 1984-1985). Thus, unattached individuals who are taken as a dependent by their parents, typically children, cannot claim the household credit.

112 Id. § 606(b)(2). New York "minimum taxable income" is defined generally as tax preference income under federal law less some special deductions. Id. § 622 (McKinney 1975 & Supp. 1984-1985).


114 Id. § 606(c)(1) (granting a credit against New York tax equal to 20% of the credit allowable against the federal income tax under I.R.C. § 44A (West 1984)).


116 See id. § 606(c)(2) (limiting the credit for married persons filing a federal joint return and a separate state return to the state tax otherwise due by the lower-income spouse).

117 See I.R.C. § 44A(a) (1982) (granting a credit for the applicable percentage of employment-related expenses); id. § 44A(d) (setting the dollar limits on the credit).
one percentage point for each $2,000 (or a fraction thereof) by which the taxpayer’s adjusted gross income exceeds $10,000 and is below $28,000.118 Thus taxpayers with adjusted gross income over $28,000 can take a credit for only twenty percent of their qualifying costs.

2. Higher Education Expenses

Taxpayers may deduct certain payments made to a higher education trust fund119 created to finance the undergraduate or graduate studies of certain “qualified beneficiaries.”120 A qualified beneficiary generally is one of the taxpayer’s dependents.121 The amount deductible is limited to $750 for each of the qualified beneficiaries of the trust fund.122 Taxpayers with three dependent children, therefore, can deduct $2,250 per year for their children’s college education.123

Taxpayers may deduct half of the tuition (less tuition assistance awards), up to $1,000, paid on behalf of their dependents if those dependents are enrolled full-time in a qualifying New York institution providing post-secondary education.124 Taxpayers may not deduct their own tuition costs,125 nor may they deduct tuition payments for any dependents who are receiving payments from a higher education trust fund.126 A mother and father filing separate returns cannot

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118 Id. § 44A(a)(2) (defining the “applicable percentage” of employment-related expenses qualifying for the credit).
119 A qualified higher education fund is generally referred to as a “Parents’ And Students’ Savings” (PASS) account and the tuition subsidy scheme is called a PASS plan.
121 See id. § 612(k)(3)(C).
122 Id. § 612(k)(1).
123 Taxpayers who obtain the trust corpus for their own use must pay a tax on its value at the time of receipt, plus a 10% penalty. Id. § 612(l). Beneficiaries are not taxed on payments from the trust at the time of receipt but must include those payments in income at a later date, generally over a five year period following the conclusion of their studies. See id. § 612(l)(2).
124 Because a qualified beneficiary of a trust fund generally must be a dependent under New York law, each spouse cannot establish a trust fund for the same individual, even when the spouses file separate returns. See infra note 127 (showing that a child cannot be a dependent of both spouses for tax purposes). A quirk in the law, however, apparently permits exactly that result when an individual qualifies as a trust beneficiary because he is a member of the armed services on active duty, a peace corps volunteer, or a full time volunteer under the Domestic Volunteer Service Act of 1973, Pub. L. No. 93-113, 87 Stat. 394. See N.Y. Tax Law § 612(k)(3)(C)(ii) (McKinney Supp. 1984-1985).
126 The payment must be made on behalf of a dependent. Id.
127 Id.
both take a deduction for the tuition payments they make for their child because a child who qualifies as a dependent of one parent will not qualify as a dependent of the other.\textsuperscript{127}

III. A Policy Evaluation of New York’s Family Taxation Rules

The previous section of this Article described the curious mixture of family oriented and individual oriented tax rules found in current New York law. This section of the Article subjects these rules to a tax policy analysis. Subsection A, below, offers a detailed critique of New York’s system for taxing married persons. Subsection B evaluates New York’s complex system of low-income relief. The issues that arise in designing a simple and fair system of dependency allowances are addressed in subsection C.

A. The Choice of an Individual Filing Rule

New York currently rejects the use of a joint return as its primary method for taxing married persons and instead endorses the use of separate returns. New York can reasonably anticipate obtaining some policy gains and suffering some policy losses by its approach. This subsection of the Article analyzes the various tax policy advantages commonly associated with an individual filing regime, and discusses tax policy disadvantages. It also explains how New York’s individual filing rule imposes serious administrative costs on the Tax Department and on the taxpaying public. Finally, it concludes that the disadvantages of individual filing easily outweigh the largely illusory advantages.

1. The Alleged Policy Advantages of Individual Filing

a. No Marriage Penalty or Bonus

Spouses in New York are allowed to report their separate incomes in essentially the same manner that they would have reported them

\textsuperscript{127} See I.R.C. § 152(a) (1982) (requiring a taxpayer to pay over half the support in order for a child to qualify as the taxpayer’s dependent); N.Y. Tax Law § 616(a) (McKinney Supp. 1984-1985) (defining New York exemptions in terms of federal exemptions).
as single persons. Consequently, New York’s endorsement of separate returns, in and of itself, does not result in a marriage penalty. Separate filing, however, is not the only mechanism that policymakers can employ to avoid the marriage penalty produced by the current federal system of family taxation. The federal system of joint returns with full income splitting, in effect from 1948 to 1971, did not produce any tax detriment upon marriage. Under full income splitting, each spouse is taxed on one-half of the combined incomes reported on the joint return, an approach that typically reduces but never increases the amount of taxes that married couples pay as compared to what they would have paid if they had remained single. In fact, from 1948 to 1971, most couples who married experienced a “marriage bonus” because their income taxes as a couple were less than the aggregate taxes they would have paid as single persons.

Another technique for eliminating the marriage penalty is to grant a special allowance for two-income couples. The allowance would exactly offset the difference between the amount of taxes that the marital partners would pay as single persons and the amount they would pay, but for that allowance, as a married couple. The federal deduction for secondary earners enacted in 1981 illustrates this mechanism. The federal allowance, however, does not eliminate the marriage penalty for all two-income couples.

Some joint filing advocates defend the “marriage penalty.” They

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128 For a detailed description of the tax treatment of married couples under New York law, see supra notes 45-54 and accompanying text.

129 Other features of New York’s tax law can produce a marriage penalty. See infra text accompanying notes 193-97.

130 See supra notes 24-27 and accompanying text.

131 See McIntyre & Oldman, supra note 15, at 1588-89 (describing the tax savings that an unwed individual would obtain by marrying an impecunious spouse). Of course, the tax advantages of marrying someone without income generally would be less than the costs of supporting that person.


In tax year 1983, 21 million married couples, representing 47.6% of joint returns filed, claimed the two-earner deduction. See Statistics Bulletin, supra note 27, at 46.

134 See Coven, supra note 10, at 1540-45 (defending some additional tax burden on married couples because of the alleged benefits of economies of scale but arguing for a tax base adjust-
argue that married persons have greater taxable capacity than equal-income single persons because of the economies of scale that they allegedly enjoy from sharing consumer durables with their spouse.\textsuperscript{135} This argument is unpersuasive for two reasons. First, married persons have no monopoly on cost-sharing arrangements. Many single persons, for example, do not live alone; some share quarters with their parents, and many others have roommates.\textsuperscript{136} Second, cost-sharing is but one of countless ways that taxpayers get extra values from their consumer purchases, yet none of these other forms of consumer surplus are treated as taxable income.\textsuperscript{137}

Although the federal joint return rule produces a marriage penalty, it also produces a "marriage bonus" for some married couples,\textsuperscript{138} a result that New York’s separate filing rule avoids. The "marriage bonus" has many defenders, principally the proponents of joint returns with full income splitting. Although they reject the label "marriage bonus" because of its negative connotations, they argue nonetheless that two single persons with unequal incomes should experience a decline in their combined tax bill if they marry and begin sharing their incomes. This position follows logically from the benefit principle, which states that the taxable capacity of married individuals is best measured by the share of the marital income they enjoy.\textsuperscript{139} For those

\textsuperscript{135} For a summary of the economies of scale argument and a telling criticism of it, see Bittker, supra note 11, at 1422-25.

\textsuperscript{136} Many single persons sharing living quarters, such as students and dependent children, are probably not on the tax roll. The Internal Revenue Service does not collect data on the number of single taxpayers sharing living quarters. See O’Neill, \textit{Family Issues in Taxation}, in \textit{TAXING THE FAMILY} 1, 5 (R. Penner ed. 1983) (reporting Census Bureau figures of 1.3 million cohabiting unmarried couples and 11.3 million adult children sharing a household with their families).

\textsuperscript{137} Examples of such consumer surplus include shopping at sales and utilizing goods efficiently. Under standard economic theory, all purchasers of goods enjoy economic surplus if the equilibrium price set for goods in the marketplace is less than the maximum amount they would have been willing to pay for the goods. For a discussion of the proper treatment of consumer surplus, see McIntyre, \textit{Commentary on Steuerle, The Tax Treatment of Households of Different Size}, in \textit{TAXING THE FAMILY} 98-103 (R. Penner ed. 1983).

\textsuperscript{138} See McIntyre & Oldman, supra note 15, at 1588-89. The "bonus" arises whenever a married couple’s income split is less even than the 80/20 split that the rate schedule for married persons filing jointly implicitly assumes.

\textsuperscript{139} \textit{Id.} at 1597-98 (arguing that an ideal income tax should recognize income splitting of unmarried couples). The marriage bonus is unfair under the benefit principle because it is not extended to unmarried couples who pool their separate incomes; consequently, a more descriptive appellation for it is a "tax on remaining unmarried." Some commentators have called this phenomena a "tax penalty on single persons." See, e.g., \textit{Tax Treatment of Married, Head of Household, and Single Taxpayers: Hearings Before the House Comm. on Ways and Means, 96th Cong., 2d Sess.} 17 (1980) (statement of Emil Sunley, Deputy Assistant Secretary for Tax Policy of the United States Department of the Treasury). The latter designation, however, can be quite misleading. The penalty applies only to those unmarried persons who are already shar-
who accept the benefit principle, the "marriage bonus" is the normal consequence in a progressive income tax system of the real changes in the enjoyment of income that single persons typically experience upon marriage. It presents a fairness problem only because it is available only to married couples. If the theory underlying a joint return is pursued to its logical end, all couples, married and unmarried, who pool their income should be taxed on the income they actually enjoy, regardless of the source of that income.\textsuperscript{440} Using marriage as the bright line test for income pooling, however, avoids the intractible administrative difficulties that would arise if a tax department were asked to verify the actual facts regarding income pooling.\textsuperscript{441}

Although New York's system of separate returns does not produce a "marriage bonus" as that term is commonly used, it does provide spouses filing separate state returns with opportunities for tax avoidance not available to single persons. For example, it explicitly authorizes spouses filing separate returns to divide their itemized deductions between themselves in order to produce the most favorable tax result.\textsuperscript{442} Furthermore, married couples can use a variety of informal techniques for shifting gross income to reduce their taxes.\textsuperscript{443}

\textit{b. Reduced Work Disincentives for Married Women}

Several commentators recently have argued for the adoption of a separate filing rule by the federal government on the ground that its adoption would increase the number of hours that married women work in paid employment without causing offsetting economic

\textsuperscript{440} Under current New York law, unmarried couples can enjoy the benefits of income splitting by getting married, getting a divorce, and agreeing to share through an alimony decree. See supra note 86 and accompanying text. This alternative may not be an attractive one to most unmarried couples because of the commitment that it requires. See Lathrope, supra note 13, at 280. That commitment, however, is not substantially greater than the one that single persons typically make when they marry. The Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 795, makes such an income splitting arrangement even less attractive by requiring that the former spouses live apart. See supra note 86.

\textsuperscript{441} See Bittker, supra note 11, at 1399 (recommending that the group permitted to split income should be "crisply defined and readily verified"); see also Lathrope, supra note 13, at 290-95 (suggesting that some modest departures from marital status under state law might be feasible and advantageous in identifying income pooling couples).

\textsuperscript{442} See supra note 68 and accompanying text.

\textsuperscript{443} See supra notes 55-66 and accompanying text.
losses. To support that proposition, these commentators cite empirical studies which indicate that secondary workers — a group presumed to include many working wives — are on average much more sensitive to marginal tax rates than are men and single women. This being so, these commentators argue that raising the marginal tax rate on husbands and lowering it on wives would increase economic efficiency. A switch from joint to separate filing would accomplish that goal, they assert, since the earnings of a husband and a wife would no longer be taxed at the marginal rate of the married couple. Instead, their marginal tax rates would be a function of their separate incomes. Because a wife typically earns less than her husband, the marginal tax rate applicable to the wife’s separate income presumably would be lower than the joint return rate, while the husband’s marginal rate on his separate income would be higher than

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144 See, e.g., Brazer, supra note 9; Gann, supra note 9; Munnell, supra note 16; Rosen, supra note 19.

145 See supra note 144. For a helpful summary of the empirical studies and an analysis of the secondary-earner deduction added to the Internal Revenue Code in 1981, see Feenberg, The Tax Treatment of Married Couples and the 1981 Tax Law, in Taxing the Family 32-63 (R. Penner ed. 1983) (concluding that the secondary-earner deduction should lead to a slight increase in labor supplied by married women — perhaps 15 hours per woman per year — if such persons are in fact paying the marginal tax of their marital partnership).

146 The efficiency case for separate filing rests upon an assumption that the wife’s marginal tax rate is a function of the marginal rate of the couple in a joint return. This assumption is unwarranted unless marital partners are assumed to pool resources, because a wife who is living on her own wages and whose income is lower than that of her husband cannot be expected to agree to pay more than her proportional share of the total taxes assessed on the couple. In the face of unreasonable demands from her husband, she would elect to file a separate federal return. Filing separately would increase the total burden on the couple, but it would also distribute that burden in proportion to the wages of the spouses, resulting in a lower burden on the wife.

If marital partners pool resources, each would view the marginal tax on the couple as a detriment, although they each would bear only one-half the marginal tax, because pooling involves a sharing of detriments as well as benefits.

Because the efficiency case for individual filing depends upon the validity of the pooling premise, no one should embrace individual filing on efficiency grounds and also reject joint filing on fairness grounds due to reservations about the extent of marital pooling. Some of the leading advocates of individual filing, however, appear to have done so. See, e.g., Brazer, supra note 9, at 227-28 (arguing that joint filing is inefficient because secondary earners would face the high marginal rate of the couple); id. at 241 (stating that in a world in which marital partners pool their income, it would be "strange to argue that the individual should be the taxable unit"); Gann, supra note 9, at 26 (rejecting income splitting on fairness grounds in substantial part because of skepticism about the extent of marital sharing); id. at 40-45 (arguing for individual filing on efficiency grounds); Munnell, supra note 16, at 266 (rejecting the pooling premise because of the prevalence of divorce); id. at 263-65 (embracing the efficiency argument for individual filing); Rosen, supra note 19, at 423 (noting with approval the view that joint filing causes "capricious changes in tax burdens when persons marry"); id. at 426 (building an efficiency case against joint filing on the ground that "[w]hen spouses file jointly, they face exactly the same tax rate on their last dollar of earnings").
the joint return rate.

The merits of the efficiency argument summarized above are a matter of serious dispute.\textsuperscript{147} Even if its merits were conceded, however, the case for individual filing on efficiency grounds at the state level is at best a makeweight. At the federal level, marginal rates go as high as fifty percent. Consequently, the change from a joint return regime to an individual filing regime could have a significant effect on the marginal tax rate that married women face in making their work decisions. At the state level, however, the maximum tax rate on earned income is ten percent, and the effective marginal rate is generally less, because those who itemize their deductions can deduct the state tax in calculating their federal income tax. For the overwhelming majority of married women, therefore, the effective marginal rate they would face under a separate return system is likely to be no more than two or three percentage points lower than the rate they would face under a joint filing system.\textsuperscript{148} No credible claim can be made that differences in marginal rates of that magnitude are likely to have significant efficiency consequences.

\textsuperscript{147} See Leuthold, Taxes and the Two-Earner Family: Impact on the Work Decision, 7 PUB. FIN. Q. 147 (1979) (reporting a preliminary empirical finding that the work decisions of secondary workers have a significant and offsetting impact on the work decisions of their spouses); Rosen, Taxes in a Labor Supply Model with Joint Wage-Hours Determination, 44 ECONOMETRICA 485 (1976) (reporting a preliminary empirical finding that lower taxes on secondary workers would increase welfare, based on the aggressive assumption that the work decisions of primary workers are completely independent of the work decisions of their spouses); Sgonz, Efficiency and the Tax Treatment of Secondary Workers, 37 NAT'L TAX J. 249 (1984) (contending that lower taxes on secondary workers do not necessarily improve welfare). For a helpful review of the economic literature, see Andic, Does the Personal Income Tax Discriminate Against Women, 36 PUB. FIN. 1, 4-10 (1981) (concluding that the efficiency case for lower marginal rates on married women is unproven, and noting that "the change in social mores is undermining the commonly accepted high elasticity of supply of the female labor force"). See also Gann, supra note 9, at 39-46 (approving the efficiency arguments for individual filing by married persons); McIntyre, supra note 10, at 485-88 (reviewing the efficiency case for individual filing and finding it deficient).

\textsuperscript{148} Under current law, the marginal rate differential for taxpayers claiming a federal standard deduction could get as high as 8% (the top rate on earned income of 10% minus the bottom rate of 2%). Such cases, however, would be rare. For wives who earned over $7,000 and itemized their federal deductions, the maximum marginal rate differential is 3% (the 10% rate minus the 6% rate on income over $7,000 minus the offset for the federal deduction), assuming a federal marginal tax rate of 25% is applied on the wife and her husband. See N.Y. TAX LAW § 602(d) (McKinney Supp. 1984-1985) (providing rate schedule). For wives who earned over $15,000, there is no differential, due to the 10% cap on personal service income. Id. § 603-A(a) (limiting the rate on earned income).
2. The Alleged Disadvantages of Separate Returns

If the taxable capacity of married individuals is best measured by the share of the marital income they enjoy, then New York's endorsement of separate returns imposes equivalent tax burdens on individuals who have very different taxable capacities. Consider, for example, two individuals, each earning $15,000. One of these individuals is single and the other is married to a person earning $75,000. Under a separate return approach, each of the $15,000 earners is viewed as having the same ability-to-pay; a separate return ignores the increase in economic well-being that results from sharing economic resources with the spouse who earns $75,000. By contrast, a joint return system with full income splitting would not treat the two $15,000 earners as similarly situated. The married person would be taxed on income of $45,000 — one half of the combined earnings of that person and the person's spouse.149

Conversely, New York's present tax regime may lead to unequal treatment among married couples with equal incomes. Commentators have frequently asserted that a fair system of family taxation should seek to tax equal-income couples equally.150 A joint filing system can achieve that goal either by taxing married couples as a unit or by making the taxable income of a married individual a function of his and his spouse's combined income.151 In contrast, a separate return regime imposes an equal tax burden on equal-income couples only when the separate incomes of the spouses are identical. Consider, for example, two married couples, both having an aggregate income of $30,000. The first couple has only one wage earner, while the second couple has two wage earners, each earning income of $15,000. Under New York's separate filing regime, the first couple's taxes will be based on $30,000 of income, while the second couple's taxes will be the sum of the taxes on each spouse's wages of $15,000. Under a progressive rate schedule, the tax on $30,000 is greater than twice the tax on $15,000.152

149 Another way of illustrating the difference between joint and separate return regimes is to consider the married person's spouse who earns $75,000 in the example provided in the text. Under New York's use of separate returns, that spouse is viewed as having the same ability-to-pay as a single person having income of $75,000. A joint return system would not treat these two individuals as similarly situated.
151 See supra notes 40-44 and accompanying text.
152 As a second example, consider two married couples, both having aggregate incomes of $40,000. The first couple has an income split of $30,000/$10,000 and the second couple has an income split of $20,000/$20,000. Again, the couple with the more even income split will pay less...
The equal treatment of one- and two-job married couples that would result from the filing of a joint return has been criticized on the ground that one-job couples avoid some of the nondeductible costs that the two-job couple frequently incurs, such as additional commuting expenses, clothing expenses, and costs of restaurant meals.183 Another basis of opposition to equal treatment of equal-income couples is that two-job couples presumably have less time than one-job couples to do housework,184 to perform home maintenance, to shop for bargains, and to engage in similar cost-saving activities.185 They also have less time for leisure activities. If quasi-business expenses such as commuting and clothing ought to be deductible, or if imputed income from leisure or from performing household chores ought to be part of gross income, then New York’s use of separate returns, with its consequent imposition of a tax on one-job couples that is higher than that on two-job couples having the same aggregate incomes, is arguably more fair than a joint return with full income splitting.186

The alleged differences in expenses and imputed income between two- and one-job couples, however, reflect systemic problems of taxation that go well beyond the treatment of married taxpayers. All taxpayers who work away from home are likely to incur extra costs and have less leisure time or time for chores than taxpayers who have only investment income. Furthermore, employment outside the home increases the cost-of-living for single persons as well as for married persons. The issue is further complicated by the fact that some taxpayers make productive use of their leisure time and some do not. In addition, working outside the home has its own set of special untaxed advantages, such as the receipt of tax-free fringe benefits187 and the accumulation of job experience and seniority.188 These complex and

tax under a progressive rate structure.

183 See, e.g., Gann, supra note 9, at 30.

184 For a report on a study showing that the hours spent doing housework typically decrease as the hours spent working outside the home increase and for a suggestion that such a finding has tax policy implications, see O’Neill, supra note 136, at 7 (table 2).

185 Id. at 5-9.

186 Many commentators, of course, are decidedly unenthusiastic about the idea that self-performed services and leisure activities should be included within the concept of taxable income. See McIntyre & Oldman, supra note 15, at 1609-18; see also Cohen, Commentary on O’Neill, Family Issues in Taxation, in TAXING THE FAMILY 27-30 (R. Penner ed. 1983).


188 Imputed income from increases in human capital is analogous to imputed income from self-performed services. See McIntyre & Oldman, supra note 15, at 1618. For a thoughtful dis-
competing considerations do not provide a principled basis for imposing extra burdens on one-job couples and on two-job couples with uneven income splits. Moreover, the extra burdens that such couples bear under a separate filing rule do not correspond in any systematic way to the advantages they allegedly enjoy over equal-income two-job couples.\textsuperscript{159}

Perhaps the most widely acknowledged defect of separate returns is the opportunity it gives to marital partners for reducing their aggregate taxes by equalizing their separate incomes.\textsuperscript{160} This result ordinarily cannot be achieved by couples whose income sources come exclusively from wages. Couples with property income and business income, however, have a good deal more flexibility for tax planning.\textsuperscript{161} Unethical taxpayers may not even need to adjust their formal ownership rights to minimize state income taxes, because the ability of the New York State Tax Department to verify actual ownership rights is modest. Separate filing thus becomes an income splitting system for well-advised taxpayers and for venturesome or fraudulent taxpayers willing to take aggressive reporting positions. At the same time, separate filing results in a tax penalty on ignorant and honest taxpayers. No policy considerations justify such results.

3. Administrative Considerations

A state income tax that makes the taxpayer's federal adjusted gross income the starting point in computing taxable income should be easy to administer. Taxpayers who have already completed their federal return should be able to fill their state return with dispatch, and the state tax authorities should be able to rely almost exclusively on the IRS to generate the information necessary for an effective audit. New York has made a policy decision to use federal adjusted gross income as the starting point in defining New York adjusted gross income. But it loses some of the administrative advantages that ordinarily would flow from that decision by not following the federal joint return rule in determining the income of married persons. The


\textsuperscript{160} For a description of the opportunities for informal income splitting under New York law, see supra notes 55-77 and accompanying text.

\textsuperscript{161} See supra notes 55-77 and accompanying text.
following subparts discuss three types of administrative costs that are directly attributable to New York's use of an individual filing rule.

a. Problems of Self-Assessment

In states such as California and Michigan, where married couples generally file joint returns, married taxpayers can easily compute their state taxable income. First, they transfer the combined adjusted gross income figure of both spouses from their federal Form 1040 to their state return. Second, they determine the combined deductions and other adjustments available to both spouses under state law, typically using their combined federal personal deductions as the starting point. Third, they subtract those adjustments from federal adjusted gross income to get the couple's taxable income.

New York marital partners who have decided to file joint returns can compute their New York taxable income as easily as their counterparts in California or Michigan. Married taxpayers filing separate returns in New York, however, must make a series of calculations and complex legal determinations to compute their New York taxable income. They must first determine their separate adjusted gross incomes. To do so conscientiously, they must familiarize themselves with the complex attribution rules of the pre-1948 federal income tax, or hire expert tax counsel. Next, they must determine the state deductions they are entitled to claim against their separate adjusted gross incomes. New York simplifies that determination by permitting married taxpayers to allocate their itemized personal deductions between themselves and their spouse in whatever fashion they choose. To choose intelligently, however, New Yorkers must know

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163 See Cal. Rev. & Tax. Code § 17045 (Deering 1975) (authorizing married persons filing joint returns to split their incomes, with each reporting one-half the combined income of the couple); id. § 18402 (Deering Supp. 1984) (authorizing marital partners to file joint returns); Mich. Comp. Laws Ann. § 206.30(1) (West Supp. 1984-1985) (defining taxable income for the Michigan tax as federal adjusted gross income, with adjustments); id. § 206.311(3) (requiring a married couple filing a joint federal return to file a joint Michigan return).

164 Before they can even begin filling out their tax return, New York marital partners should determine the relative advantages of filing separate and joint returns. To make that determination, many married taxpayers would be well-advised to compute their tax liability twice — once as joint filers and once as separate filers — and then compare the results. These calculations are particularly important for couples with one major earner and one minor earner. See supra note 101 and accompanying text.

165 For a discussion of the attribution rules of the pre-1948 federal income tax, see supra notes 52-67 and accompanying text.

166 See supra note 68 and accompanying text.
how their choice will affect their tax liability. Contrary to popular belief, New York marital partners do not always get the optimal benefit by allocating the deductions to the higher-income spouse.\textsuperscript{166} For many New Yorkers who benefit from the ten percent ceiling on the rate on personal service income, the spouse with the higher adjusted gross income may not be the one subject to the higher marginal tax rate.\textsuperscript{167}

New York's separate return system is also partially responsible for the complexity produced by the household credit and other low-income relief measures.\textsuperscript{168} While some of that complexity is due to inartful design, some is the unavoidable result of combining a filing rule that ignores marital sharing in computing taxable capacity with low-income relief mechanisms that take marital sharing into account. A recent study concerning types of substantive mistakes taxpayers made in filing their tax returns showed that the household credit is a major source of taxpayer error.\textsuperscript{169}

b. Audit Problems

New York's individual filing rule complicates matters for the Tax Department in two important ways. First, it reduces the value of information that the Tax Department obtains from federal tax forms

\textsuperscript{166} The Tax Department has encouraged the popular belief regarding the allocation of deductions. The Form IT-201 Instructions for the year 1983 advise married persons filing separately to "divide [their] itemized deduction[s] so that both incomes are the same." N.Y. STATE DEPT OF TAXATION & FIN., 1983 INSTRUCTIONS FOR FORM IT-201, at 13 [hereinafter cited as 1983 INSTRUCTIONS].

\textsuperscript{167} Consider, for example, two marital partners, one with wage income of $30,000 and the other with wage income of $17,000. Assume that the lower-income spouse has investment income of $4,000 and that the couple is entitled to personal deductions totaling $2,000. By electing to allocate all $2,000 of deductions to the higher-income spouse, the couple would reduce their aggregate tax burden by $200 — the tax otherwise due on the last $2,000 of personal service income of the higher-income spouse. Allocating the $2,000 of deductions to the lower-income spouse, however, would reduce the aggregate tax burden by $240, because the personal deductions would shelter $2,000 of investment income that otherwise would have been taxed at a rate of 12%. See N.Y. TAX LAW § 602(d) (McKinney Supp. 1984-1985) (rate schedule); id. § 603-A(a) (maximum rate on personal service income).

\textsuperscript{168} For a description of the household credit and other relief measures, see supra notes 102-13 and accompanying text.

\textsuperscript{169} According to an unpublished study undertaken by the Tax Study Commission, approximately 250,000 single persons entitled to the household credit failed to claim it. Data on married persons is unavailable. Unpublished data provided to the Tax Study Commission by the New York State Tax Department show that 46% of the 196,003 errors requiring that a return be sent back to the taxpayer for proper completion were due to an improperly claimed secondary-earner deduction and that 6% of such errors were due to filing status mistakes.
and from reports furnished by the IRS on the results of federal audits. Like all of the other states administering an income tax, New York depends heavily upon information obtained from the IRS for enforcement. Neither the joint federal returns of marital partners nor the audit reports prepared by the IRS, however, show the separate incomes of the spouses. Thus the Tax Department is on its own, at least in part, in enforcing an important element of the New York tax. The Tax Department still benefits from the information contained in the Forms 1040 and the IRS audit reports of joint filers, but to make use of that information, it typically must make additional inquiries with the IRS or with the taxpayers themselves.

The use of separate returns also forces the Tax Department to sacrifice some clarity in the filing instructions provided for taxpayers. Ideally, the Tax Department could offer different filing packages — tax forms and line-by-line filing instructions — for wage earners with modest amounts of investment income and for those engaging in complex financial transactions. This approach, employed with some success by the IRS, would help prevent average taxpayers from getting confused by tax rules that are irrelevant to the determination of their tax liability. New York does have two filing forms, Form IT-200 (short form) and Form IT-201 (long form). The short form, however, cannot be used by married persons filing separately. Of course the Tax Department, at some expense, could design a third form for those married taxpayers filing separately whose incomes are derived principally from wages. That form, however, could not be as simple as Form IT-200, which avoids most complications by directing taxpayers to incorporate the numbers they have just reported on their federal return. To be useful, the “simple” separate filing form for married taxpayers would need to instruct taxpayers how to separate their joint deductions and how to determine the proper taxpayer on investment income. Currently, Form IT-201 does not provide such guidance, perhaps because it is so hard to give.

In an attempt to meet the needs of taxpayers engaging in relatively simple financial transactions, the Tax Department recently introduced a new table into the instruction booklet that accompanies Form IT-201. The new table was created to let taxpayers determine the amount of their standard deduction — minimum standard deduction, maximum standard deduction, or percentage standard deduction — without having to compute it themselves. Unfortu-

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170 See 1983 INSTRUCTIONS, supra note 166, at 16.
171 Id.
nately, the Tax Department was foiled by the complexity of the rules that it was attempting to explicate.

While the table itself is useful, the accompanying instruction booklet fails to state explicitly that marital partners who file separately must combine their adjusted gross incomes before looking up their standard deduction in the table. In addition, the booklet does not indicate that the amount shown in the table is the total standard deduction allowable per couple. To the contrary, the instructions seem to imply that each married person filing a separate return is entitled to the full amount of the standard deduction shown in the table.\textsuperscript{172} In an attempt to correct the misperception it had created, the Tax Department issued a clarifying notice to tax practitioners.\textsuperscript{173} Those taxpayers who are unaware of the notice, however, may be misled into claiming too large a standard deduction. The Tax Department will be required to issue notices of tax due, and taxpayers receiving those notices will be reinforced in their perceptions that the state income tax is unduly complicated.

c. Consequences of Federal Limitations on Married Persons Filing Separately

Since its reduction of the tax rates on single persons in 1969,\textsuperscript{174} Congress has frequently placed special limits on the deductions, exclusions, and other benefits that may be claimed by married persons filing separately. The apparent policy underlying these limitations is to prevent marital partners in community property states from splitting their combined incomes, filing separate federal returns, and thereby gaining a tax advantage not available to marital partners residing in common law jurisdictions.\textsuperscript{175} These limitations sometimes have an unintended effect on the New York tax liabilities of married persons filing separately because New York generally permits such persons to claim only those deductions, exclusions, and other allowances that the federal government would have permitted them to take if they had filed separate federal returns.\textsuperscript{176}

\textsuperscript{172} \textit{Id.}

\textsuperscript{173} \textit{See Notice to Tax Practitioners, [3 N.Y.] ST. TAX REP. (CCH) ¶ 250-916 (Jan. 5, 1984).}


\textsuperscript{175} \textit{See Lathrope, supra} note 13, at 264 n.21.

\textsuperscript{176} \textit{See supra} note 60 and accompanying text.
New York can respond to the limitations on allowances available to separate filers with legislative action or it can acquiesce in the constructive amendment of its tax law. If it does not respond with legislation in timely fashion, it should anticipate a high degree of taxpayer noncompliance, for it is unlikely, absent a determined educational campaign by the Tax Department, that the majority of New York taxpayers filing separately will understand the impact of such an obscure feature of federal law.

The recent federal change in the taxation of social security benefits\(^{177}\) illustrates how the federal limitations on allowances granted to marital partners filing separate returns can have unintended, but dramatic, consequences for large numbers of New York taxpayers. Starting in 1984, the federal government will tax up to one-half of a recipient’s social security benefits if the recipient’s adjusted gross income exceeds a base amount.\(^{178}\) The base amount is $25,000 for single persons and $32,000 for married persons filing a joint return. For married persons filing a separate federal return, however, the base amount is zero.\(^{179}\) That is, such persons have no tax-free base amount but instead are taxable on one half of all social security benefits that they receive. Absent action by the New York State Legislature, the latter result would follow automatically under state law for married persons filing separate New York returns. The Legislature recently amended the state tax law, however, to provide an explicit tax exemption for all social security benefits.\(^{180}\)

\(^{177}\) See The Social Security Amendments of 1983, Pub. L. No. 98-21, § 121(c), 97 Stat. 65, 80 (codified at I.R.C. § 86 (West 1984)).

\(^{178}\) See I.R.C. § 86 (West 1984).

\(^{179}\) Id. § 86(c)(3).

\(^{180}\) See 1984 N.Y. Laws ch. 71, § 1 (McKinney) (codified at N.Y. TAX LAW § 612(c)(3-b) (McKinney Supp. 1984-1985)).

A similar situation arose from the federal government’s action in 1978 to tax a portion of unemployment compensation insurance benefits. See Revenue Act of 1978, Pub. L. No. 95-600, § 112(a), 92 Stat. 2763, 2777 (codified as amended at I.R.C. § 85 (1982)). The base amounts were lowered significantly by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 611(a), 96 Stat. 324, 706 (codified at I.R.C. § 85). For federal purposes, part or all of a recipient’s unemployment compensation in excess of a base amount is now taxable. The base amount is $18,000 for married persons filing jointly, $12,000 for single persons, but zero for married persons filing separately. See I.R.C. § 85. As a result of the federal treatment of married persons filing separately, married persons filing separately in New York became liable for New York tax on their unemployment compensation without the benefit of any tax-free base amount. The New York State Legislature ultimately responded by changing state law. See 1984 N.Y. Laws ch. 961, § 1 (McKinney) (to be codified at N.Y. TAX LAW § 612(c)(3-b)(i)(i)). Starting in 1984, the state will tax only that amount of unemployment compensation that is taxable for federal purposes. See N.Y. TAX LAW § 612(f) (McKinney Supp. 1984-1985) (incorporating by reference I.R.C. § 85). As a result, marital partners who file separately for state purposes, but jointly for federal purposes, will now receive the benefit of the $18,000 base amount in comput-
4. Summary and Evaluation

Individual filing can be fairer than some types of joint filing systems. For example, a joint filing system that treats a husband and wife as if they were one person and subjects their combined incomes to the same rate schedule applicable to single persons is probably the least fair of the various approaches to family taxation which have been seriously discussed by tax specialists. Yet New York offers precisely that system of aggregation without splitting as the alternative to its system of separate returns for marital partners.

In comparison with a joint filing system that permits full income splitting, an individual filing system has few virtues at the state level. While individual filing produces a fairer result for certain unmarried couples, it achieves that result at the cost of substantial unfairness for the far more sizable group of married couples with unequal separate incomes who pool and share their resources.

Even if the policy debate between joint and separate return advocates were considered to be a standoff, administrative considerations heavily favor the use of a joint return. Separate returns impose a serious administrative burden on both the New York State Tax Department and on the taxing public. The Tax Department has avoided the difficult problem of determining the “true” separate incomes of spouses by generally acquiescing in the manner in which a married couple allocates its property income. To do otherwise, the Tax Department would need to divert a substantial part of its allocation their New York tax.

The so-called spousal Individual Retirement Account (IRA) deduction represents still another area where the state was pressured to amend its law because it was out of step with the federal approach. For federal purposes, a married couple filing a joint return can generally deduct contributions made to a non-working spouse’s IRA as long as the aggregate contributions to the taxpayer’s IRA and that of his spouse do not exceed $2,250. See I.R.C. § 219(a), (c) (1982). Married persons filing separate returns are limited to a federal deduction of $2,000 which may not exceed the amount of their own wages. Id. § 219(a), (b)(1). In effect, one-job couples filing joint returns are eligible for a federal IRA deduction that is $250 more than that allowed to one-job couples filing separately. Because New York generally permits federal joint filers to take only deductions that they could have taken under the federal income tax laws if they had filed separately, one-job couples in New York were initially limited to a combined IRA deduction of $2,000. New York, however, amended its law in 1984 to allow married taxpayers to deduct the full IRA deduction claimed on their federal joint return. See 1984 N.Y. Laws ch. 71, § 2 (McKinney) (codified at N.Y. Tax Law § 612(f)).

This form of joint filing is prevalent in Europe. For a summary of European family taxation rules, see Organisation for Economic Co-operation & Dev., Comm. on Fiscal Affairs, The Treatment of Family Units in OECD Member Countries Under Tax and Transfer Systems (1977). Many American commentators have favored compulsory joint filing without splitting, and it was actively promoted by the Treasury Department at the start of World War II. See Bittker, supra note 11, at 1408-11.
ready scarce resources to the formulation, audit, and adjudication of a detailed set of family income attribution rules.

In view of the dubious gains to the state from its use of separate returns, a massive reallocation of resources to determine the true incomes of married persons would be an obvious folly. By tolerating marital income shifting, however, the Tax Department gives married partners the effective power to divide property income between themselves in the most advantageous manner. Similar opportunities generally are not available to couples having earned income unless they engage in sophisticated tax avoidance transactions. In effect, a privileged class of married persons can engage in self-help income splitting, while workers typically cannot. Ironically, this bias in favor of taxpayers with property income works at cross purposes to New York's policy of taxing unearned income at a higher rate — a policy that is implicit in the ten percent ceiling on the marginal tax rate applicable to personal service income.\textsuperscript{182}

B. Relief for Low-Income Taxpayers

New York's tax system seeks to exempt from income tax those persons who are considered poor by community standards. The personal exemptions, minimum standard deduction, and household credits\textsuperscript{183} combine to exempt many low-income households from taxation. The amounts that are tax-free under these mechanisms are rarely exceeded by the low-income exemption of either $2,500 (covering a single individual who is not a head of household or a surviving spouse) or $5,000 (covering all others) that New York provides.\textsuperscript{184} The low income exemption, therefore, plays almost no role in relieving low-income taxpayers from tax liability.\textsuperscript{185}

\textsuperscript{182} See N.Y. Tax Law § 603-A(a) (McKinney Supp. 1984-1985).

\textsuperscript{183} For a description of the personal exemptions, minimum standard deduction, and household credits, see supra notes 102-13 and accompanying text.

\textsuperscript{184} See supra note 102 and accompanying text. A single person claimed as a dependent would get a small benefit from the $2,500 exemption, since apart from the exemption, his tax-free amount would be only $2,300 ($1,500 standard deduction plus $800 personal exemption).

\textsuperscript{185} Consider, for example, a single person, not claimed as a dependent by any other taxpayer, who is entitled to a $2,500 low-income exemption. Quite apart from the $2,500 exemption, such a taxpayer is entitled to a personal exemption of $800, a minimum standard deduction of $1,500, and a household credit of $70. These three mechanisms reduce the taxpayer's tax liability to zero, making the $2,500 low-income exemption superfluous. In fact, the combination of the personal exemption, the standard deduction, and the household credit provides a total exemption from taxation of $4,967 for single persons not claimed as dependents. An individual with adjusted gross income of $4,967 could subtract $800 for his personal exemption and $1,500 for his minimum standard deduction, yielding taxable income of $2,667. The tax on $2,667
The low-income exemption does provide a small benefit to single taxpayers claimed as a dependent by another taxpayer, since these taxpayers, typically dependent children, are not entitled to the household credit. Because the low-income exemption can reinforce the incentive that parents already have for federal purposes to shift income to children who are in lower marginal tax brackets, it undermines the household credit’s policy of limiting low-income relief to the genuinely poor.

Because the household credit is the same for all types of households at the same income level, and because the minimum standard deduction is nearly the same for all households, the differential in burdens for family obligations is a result of the $800 per capita personal exemptions. Data concerning the tax-free amounts available to different types of households, the per capita tax-free

under the rate schedule (prior to allowance for the household credit) is $20 plus 3% of $1,667 ($50) for a total of $70. See N.Y. Tax Law § 602(d) (McKinney Supp. 1984-1985). The household credit of $70, id. § 606(b)(2), would reduce the taxpayer’s liability to zero. A similar analysis would show that married persons receive no benefit from their low-income exemption of $5,000. A married person with income of $5,000 would have taxable income of $2,200. His tentative tax, before the household credit, would be $56, reduced to (but not below) zero by the $70 household credit.

The deduction is $1,500 for single persons and $2,000 for all others. See supra note 106.

TOTAL TAX-FREE AMOUNTS UNDER 1983 NEW YORK LAW BY TYPE OF HOUSEHOLD AND NUMBER OF DEPENDENTS

<table>
<thead>
<tr>
<th>Households</th>
<th>0</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unattached Individuals*</td>
<td>5,000 N/A N/A N/A N/A N/A</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>One-parent Families</td>
<td>N/A</td>
<td>5,770</td>
<td>6,230</td>
<td>7,000</td>
<td>7,670</td>
<td>8,470</td>
</tr>
<tr>
<td>Married Couples</td>
<td>5,770</td>
<td>6,230</td>
<td>7,000</td>
<td>7,670</td>
<td>8,470</td>
<td>9,270</td>
</tr>
<tr>
<td>Surviving Spouses</td>
<td>5,000</td>
<td>5,770</td>
<td>6,230</td>
<td>7,000</td>
<td>7,670</td>
<td>8,470</td>
</tr>
</tbody>
</table>

N/A = Not Applicable

* Persons who are single and not claimed as a dependent by any taxpayer.

The figures in this table were derived by applying the New York low-income relief mechanism to the 1983 rate schedule contained in N.Y. Tax Law § 602(d) (McKinney Supp. 1984-1985). The figures are rounded and assume that taxpayers have no New York minimum income, are New York taxpayers, and elect the minimum standard deduction. A single person with $4999.99 of income actually would pay taxes of one dollar under current law. See supra note 185 for the method of computation. An additional penny of income, however, would cause that person to pay $16 in taxes because of the inelegant phase-out mechanism for the household credit.
amounts,\textsuperscript{188} and the tax-free amounts as a percentage of the 1982 federal poverty levels,\textsuperscript{189} illustrate the effect of the state's low-income relief; unattached individuals and surviving spouses are exempt from tax on income below the federal poverty line, but some tax is ex-

\begin{table}
\begin{center}
\begin{tabular}{|l|c|c|c|c|c|c|}
\hline
Households & 0 & 1 & 2 & 3 & 4 & 5 \\
\hline
Unattached Individuals & 5,000 & N/A & N/A & N/A & N/A & N/A \\
One-parent Families & N/A & 2,885 & 2,077 & 1,750 & 1,534 & 1,411 \\
Married Couples & 2,885 & 2,077 & 1,750 & 1,534 & 1,411 & 1,324 \\
Surviving Spouses & 5,000 & 2,885 & 2,077 & 1,750 & 1,534 & 1,411 \\
\hline
\end{tabular}
\end{center}
\end{table}

N/A = Not Applicable

This table was derived from the data provided in the table set forth supra note 187.

\begin{table}
\begin{center}
\begin{tabular}{|l|c|c|c|c|c|c|}
\hline
Households & 0 & 1 & 2 & 3 & 4 & 5 \\
\hline
Unattached Individuals & 102 & N/A & N/A & N/A & N/A & N/A \\
One-parent Families & N/A & 92 & 81 & 71 & 66 & 64 \\
Married Couples & 92 & 81 & 71 & 66 & 64 & 62 \\
Surviving Spouses & 102 & 92 & 81 & 71 & 66 & 64 \\
\hline
\end{tabular}
\end{center}
\end{table}

N/A = Not Applicable


For 1982, the poverty thresholds for nonfarm families were:

\begin{center}
\begin{tabular}{|c|c|}
\hline
Amount & Number in Household \\
\hline
$4,900 & 1 \\
6,280 & 2 \\
7,690 & 3 \\
9,860 & 4 \\
11,680 & 5 \\
13,310 & 6 \\
14,980 & 7 \\
\hline
\end{tabular}
\end{center}

\textit{Id.} The poverty levels were initially set at three times the cost of food for a minimum diet. Food costs were based upon a United States Department of Agriculture finding that families of three or more spend a third of their income on food. The figure is slightly higher for smaller families. The poverty thresholds are adjusted annually for inflation. See Feld, \textit{Fairness in Rate Cuts in the Individual Income Tax}, 68 Cornell L. Rev. 429, 435 n.39 (1983) (citing U.S. Bureau of the Census, Current Population Reports, Ser. P-60, No. 124, Characteristics of the Population Below the Poverty Level: 1978, app. A, at 205).
tracted from families below the poverty level. Large families below the poverty level are treated quite harshly.

Since poverty is normally thought of as a function of family income and wealth rather than of individual income and wealth, policymakers who want to exempt the poor from income tax must take family status into account in designing a system of low-income relief. New York takes into account a portion of the subsistence needs of families through the dependency exemptions. Because the dependency exemptions are available to all taxpayers with dependents, not just poor taxpayers, they serve the additional function of adjusting for the family responsibilities of taxpayers above the low-income relief cutoff point. Dependency allowances that were designed to relieve the poor from taxation, however, may not serve that additional function well.

New York's system of low-income relief has several anti-marriage and anti-family biases that are difficult to defend on tax policy grounds. The household credit has two anti-family features. First, it provides a flat credit to all households, despite the obvious fact that it costs more to maintain a multi-member household than it does a one-person household. To reflect the per capita needs of households, the household credit should be tied to the number of persons that the taxpayer is required to support. The second anti-family bias results from the mechanism chosen to phase out the credit. The phase-out mechanism reduces the amount of the credit as "household gross income" increases. Because household gross income is calculated without regard to any personal or dependency exemptions, a household with many dependents may receive a household credit substantially smaller than that received by an unattached individual with the same or even greater taxable income. Since taxable income is the accepted standard for equality of position under New York law, it should be used instead of adjusted gross income in the phase-out

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190 A dependent child, for example, generally is not considered poor if his parents have an income adequate to support him, nor is a wife considered poor if her husband's income is sufficient to bring the couple over the poverty threshold.

191 See supra notes 92-93 and accompanying text.

192 A proper dependency exemption for the poor would be one that is high enough to exclude from the income tax poor families, defined according to some agreed poverty standard. For the nonpoor, the proper function of the dependency exemption is to relieve parents, or other persons supporting a dependent, from tax on some or all of their income sources actually or presumptively shared with their dependents. See infra note 215 and accompanying text.

193 See N.Y. TAX LAW § 606(b)(2) (McKinney Supp. 1984-1985) (specifying the amount of the credit per household in terms of the amount of "household gross income"); id. § 606(b)(3) (defining "household gross income" generally as the adjusted gross income of unmarried persons and the combined adjusted gross income of husbands and wives).
mechanism.

An anti-marriage feature of the credit arises because the credit provides the same benefit to all households.194 Consequently, two unmarried low-income persons receive a larger combined household credit than they would receive as a married couple.195

The minimum standard deduction196 also gives disproportionate per capita relief to single persons and produces a tax on marriage. Single persons receive a minimum standard deduction of $1,500 while couples receive $2,000. On a per capita basis, however, the deduction for single persons is fifty percent greater ($1,500 versus $1,000) than the deduction granted to married persons. Moreover, all families, regardless of size, receive the same $2,000 deduction. Arguably a smaller per capita deduction for married persons is justifiable because their per capita subsistence costs typically are lower than those of unattached individuals,197 but no one has suggested that these costs are as low, relative to single persons, as New York law suggests.

Whatever the merits of the existing system of low-income relief, it needlessly introduces an additional complication to the preparation of an already complicated tax return. Simplicity is especially desirable in designing low-income relief because the affected taxpayers are those who may be least able to deal with complexity.

No significant policy gains result from employing both a household credit system and a minimum standard deduction to grant tax relief to low-income households. A minimum reform would combine both into one relief mechanism. Because of the relationship of the minimum standard deduction to the percentage standard deduction — a taxpayer can claim a deduction of seventeen percent of New York adjusted gross income, not to exceed $2,500 but not less than $1,500 for single persons or $2,000 for married couples198 — the minimum

194 This result follows from the fact that adjusted gross income, which is computed without regard for the personal exemptions, is the starting point in the computation of household gross income. See supra note 112 and accompanying text.

195 Two single persons, for example, each earning $5,000, would be entitled to a total household credit of $110 before marriage. After marriage, their combined household credit would be only $40. See N.Y. Tax Law § 606(b)(2) (McKinney Supp. 1984-1985).

196 See supra notes 106-09 and accompanying text.

197 The per capita subsistence costs, shown in the table set forth supra note 188, decrease as the number of members in a household increases. The federal poverty figures reflect household costs for households of different sizes without regard for the composition of those households. See supra note 189. An individual sharing a household can be expected to have lower per capita living costs than an individual living alone.

198 See N.Y. Tax Law § 614(a), (b) (McKinney Supp. 1984-1985) (granting a standard deduction of the lesser of 17% of New York adjusted gross income and $2,500); id. § 614(c) (granting a minimum standard deduction of $1,500 for unattached individuals and $2,000 for others).
standard deduction cannot easily be converted to a credit. Thus to combine the household credit and the minimum standard deduction into a single low-income relief mechanism, the household credit should be converted into a deduction and folded into the minimum standard deduction by increasing the amount of the minimum. By adjusting the existing rate structure and increasing the minimum standard deduction, a unified low-income relief mechanism could be designed that would grant approximately the same tax relief to households as is now granted by the existing complex system of allowances.  

Melding the household credit into the minimum standard deduction would remove the need for the complicated phase-out provisions of the existing household credit. The combined low-income relief would automatically be phased-out because it would be in lieu of New York's percentage standard deduction. That is, taxpayers claiming the percentage standard deduction would still be prohibited from claiming the minimum standard deduction. Alternatively, a simple phase-out mechanism could be designed that would be independent of the percentage standard deduction, a provision that may not survive comprehensive reform of the tax base.

A few states, including California, have used credits rather than deductions to grant low-income relief. Credits provide the same amount of tax savings for all taxpayers, without regard to income level. In a graduated income tax, the benefit of a deduction is a func-

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199 The basic approach to unified low-income relief is presented infra notes 261-79 and accompanying text. For a recommendation of unified low-income relief at the federal level, see McIntyre & Oldman, Chapter Six: Treatment of the Family, in COMPREHENSIVE INCOME TAXATION 221-23 (J. Pechman ed. 1977).

200 See supra notes 106-08 and accompanying text. The federal income tax employed this phase-out mechanism for its low-income relief from 1964 to 1977. See supra note 110.

201 Taxpayers in California are entitled to a base tax credit of $25 ($50 for marital partners filing jointly) for themselves and a credit of $8 for each qualifying dependent. See CAL. REV. & TAX. CODE § 17054 (Deering Supp. 1984). These amounts are adjusted upward for post-1978 inflation. Id. § 17054(h). For 1983, the taxpayer credits were $38 ($76 for marital partners filing jointly) and $12 for dependents. See Credits for Personal and Dependency Exemptions [1 Cal.] ST. TAX REP. (CCH) ¶ 15-207 (Aug., 1984).

Generally, California follows federal law in specifying who is entitled to the personal and dependency exemptions. See CAL. REV. & TAX. CODE § 17056 (Deering 1975). California does not grant the extra exemption for persons over 65. Id. § 17054 (Deering Supp. 1984). It does give an extra exemption to blind persons. Id. § 17054(d), (f).

California provides for low-income relief through a phased-out tax credit. The credit is $40 for single persons and $80 for married couples, adjusted for post-1978 inflation. The full credit is available to single persons whose income is below $5,000 and to married couples and heads of household whose income is below $10,000. For each dollar above these amounts, the credit is reduced by 50¢. Id. § 17069.
tion of the taxpayer's marginal tax rate. Credits generally are preferable to deductions when the purpose of the allowance is to provide a subsidy to taxpayers for reasons not germane to the measurement of ability-to-pay. Credits can also be an effective mechanism for reforming the distributional effects of a rate schedule that political leaders are unwilling to amend explicitly. But credits are generally inferior to deductions when the purpose of the allowance is to recognize differences in taxable capacity of taxpayers. In a flat-rate income tax, however, there is no significant distributional difference between credits and deductions.

No system of low-income relief should be considered complete unless it takes into account the minimum subsistence needs of one-parent families. A single person with one or more children is currently subject to New York tax at income levels considerably below the federal poverty thresholds. This defect in New York law could be cured in part by increasing the low-income allowance for all unattached individuals. An increase in the dependency exemption sufficient to take two-parent families below the federal poverty level off the tax roll would also reduce the excess burden now placed on one-parent households. To cure fully the defect in current law, however, New York would need to grant the head of a one-parent family a low-income allowance greater than the allowance granted to unattached single persons. The administration of such a measure would be simplified substantially by granting it only to those taxpayers filing a federal return as a head of household.

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202 See infra note 217 and accompanying text.
203 See supra note 189.
204 A married couple and a one-parent family of two have exactly the same tax-free amount under current New York law, see supra note 187, and both types of households are taxable even when their income is below the 1982 federal poverty level. See supra note 189. Married persons below the poverty level can be taken off the tax rolls by giving them the same per capita low-income allowance granted to single persons. One-parent families could be given equivalent relief by increasing substantially the dependency deduction for the first child. The latter approach, however, would give an unwarranted benefit to two-parent families with children. New York can avoid that result by granting a special low-income allowance to one-parent families.

A special low-income allowance for one-parent families would introduce an unfortunate "tax on marriage" for low-income unmarried couples with children, since such couples would be able to increase their combined tax-free amount by getting a divorce and having each spouse file as head of a one-parent family. The absolute amounts of the marriage penalty would be small since the New York tax rates applicable to lower-income persons are low. See N.Y. Tax Law § 602(d) (McKinney Supp. 1984-1985). New York could eliminate the marriage penalty for all practical purposes by prohibiting any formerly married person sharing a household with his or her former mate from filing as a head of household.

206 The Internal Revenue Code generally defines a head of household as an unmarried person
C. Tax Treatment of Dependents

Like most tax jurisdictions, New York grants exemptions to taxpayers for some portion of the costs they incur in supporting their children and other dependents. The principal mechanism for granting such tax relief is the $800 dependency exemption. Taxpayers are also eligible to receive a modest credit for the work-related costs of caring for certain dependents, and they can deduct some of the actual or expected expenses of their children’s higher education.

1. Allowances for Dependents

Tax policy theorists are hopelessly divided over the proper treatment of the costs attributable to raising children. The “tax expenditure school” asserts that these costs constitute consumption expenditures of the parents and should be fully taxable to them. Dependency allowances are considered to be a government subsidy to families which must be justified according to traditional spending criteria. The “benefit principle school” states that income spent by parents for the benefit of their children is properly taxable to the children and properly deductible by the parents, following the same line of reasoning that justifies income splitting between husbands and wives. The “discretionary income school” argues that amounts spent for basic subsistence needs of children somehow fall outside the definition of income.

who is not a surviving spouse and who maintains a household for a dependent child. I.R.C. § 2 (1982). New York has no good policy reason to deny head of household status to surviving spouses who are maintaining a household for a dependent. Because a taxpayer’s status as a surviving spouse would appear on his federal tax return, New York could extend head of household status to surviving spouses with dependent children without creating a major problem for the New York State Tax Department.

See supra note 92 and accompanying text.
See supra notes 114-18 and accompanying text.
See supra notes 119-27 and accompanying text.
See, e.g., H. SIMONS, PERSONAL INCOME TAXATION 140 (1938) (arguing that raising children is a form of consumption for the parents).
For an explanation of the applicability of a tax expenditure analysis to arguments for the dependency deduction, see McIntyre, A Solution to the Problem of Defining a Tax Expenditure, 14 U.C.D. L. Rev. 79, 94-96 (1980).
See McIntyre & Oldman, supra note 15, at 1602-07.
See, e.g., H. GROVES, FEDERAL TAX TREATMENT OF THE FAMILY 10, 23-24 (1963) (suggesting that amounts needed for basic subsistence should be outside the concept of income); Feld, supra note 189, at 434-36, 448-49 (arguing that exemptions should protect from tax an amount sufficient to cover subsistence at a modestly acceptable level of comfort).
All three of these approaches could justify sufficiently generous dependency allowances to keep families below the poverty level off the tax rolls.\textsuperscript{213} For families above the poverty line, however, the policy recommendations emanating from the three dependency deduction theories diverge substantially. The tax expenditure school favors credits over deductions because there are no good reasons for granting larger subsidies to high-income taxpayers than to middle-income taxpayers.\textsuperscript{214} Taken to its logical conclusion, the subsidy or spending rationale for dependency allowances would require refundable credits for those near or below the poverty line, with a phase-out mechanism that eliminates the credit for middle and upper-income taxpayers.

The benefit principle school, recognizing the political and administrative obstacles to family income splitting in the United States, favors deductions over credits, and variable deductions over per capita deductions. Members of this camp object to credits on the ground that, by giving the same dollar amount of allowance for all dependents, credits provide a poor approximation of the tax savings that families would enjoy if income earned by the parents and spent on the children were deductible by the parents and taxable to the children.\textsuperscript{215}

\textsuperscript{213} For a classification of the theories supporting the dependency deduction and the conclusion that all the theories justify deductions sufficient to keep poor families off the tax roll, see Steuerle, supra note 10, at 92-94.


\textsuperscript{215} See McIntyre & Oldman, supra note 15, at 1603-05 (arguing for dependency deductions as an approximation of family income splitting); Steuerle, supra note 10, at 80-82 (arguing for some form of family income splitting on equal sacrifice grounds).

Consider, for example, a family of three (husband, wife and child) with sufficient income such that one or both of the parents are in the 14\% tax bracket, the top New York rate. See N.Y. \textsc{TAX LAW} § 602(d) (McKinney Supp. 1984-1985). The family would save $120 in taxes if the higher-income parent were able to deduct $1,000 spent on the child, and the child were taxed on the $1,000 at the lowest New York rate of 2\% ($1,000 \times 14\% \text{ minus } $1,000 \times 2\% \text{ equals } $120). For parents in the 8\% bracket, however, the shifting of $1,000 of income to their child would produce a family tax savings of only $60 ($1,000 \times 8\% \text{ minus } $1,000 \times 2\% \text{ equals } $60). A uniform allowance to both families, therefore, would be unfair under the benefit principle. Assuming that all parents spend $1,000 on their offspring per year, a deduction of $800 (the current level in New York for one dependent) to both sets of parents would produce results approximately equal to the answer suggested by the benefit principle. To duplicate exactly the benefits of income splitting, the parents in the 14\% bracket should be allowed a deduction of $857 ($120/14) and the parents in the 8\% bracket should be allowed a deduction of $750 ($80/0.08). Generally, deductions are less generous to middle- and upper-income taxpayers with children than the benefit principle would require, but deductions better reflect the correct benefit-principle result than do credits. Obviously, most parents spend far more than $1,000 on a child. This fact suggests that the current level of the dependency allowance in New York (and in the federal income tax) is inadequate. For a discussion of the factors to be taken into account in determining the level of dependency allowances under the benefit principle, see McIntyre &
The discretionary income group favors deductions over credits because they believe that the subsistence costs of raising children are akin to business expenses, medical expenses, casualty losses, and other expenditures that arguably reduce ability-to-pay.\textsuperscript{216} Given the premise that nondiscretionary child-support costs are not properly taxable, providing a credit for dependents is just as inappropriate as granting a credit for legitimate business expenses.\textsuperscript{217}

Assuming that the dependency exemptions are intended to differentiate the tax burdens of families of different sizes, the present level of exemptions is inadequate.\textsuperscript{218} A family of four with wage income of $40,000, for example, would pay only about $160 less in taxes under current law than a childless couple with the same earnings.\textsuperscript{219} The present $800 deduction is also too low to keep poor families off the tax roll, but that problem could be remedied by granting married couples and heads of household a more liberal low-income allowance.\textsuperscript{220}

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Oldman, \textit{supra} note 15 at 1602-07.

\textsuperscript{216} \textit{See}, e.g., Brannon \& Mors, \textit{The Tax Allowance for Dependents: Deductions Versus Credits}, 26 Nat'l Tax J. 599 (1977) (arguing that dependency allowances should exempt families from taxation on subsistence income).

\textsuperscript{217} To see the defect of a credit for business expenses, consider four taxpayers, A, B, C, and D, where (1) A has gross income of $100,000, legitimate business expenses of $10,000, and a net income of $90,000; (2) B has gross income of $90,000, no business expenses, and a net income of $90,000; (3) C has gross income of $20,000, legitimate business expenses of $10,000, and a net income of $10,000; (4) D has gross income of $10,000, no business expenses, and a net income of $10,000. In a properly designed graduated income tax, A and B would pay the same tax and C and D would pay the same tax, a result easily achieved by granting A and C a deduction for their business expenses. In a flat-rate income tax, A and C could each be given a credit equal to the tax on $10,000, and the system would also operate correctly. But consider if A is subject to a marginal tax rate of 10\% and C is subject to a marginal rate of 5\%. A tax credit of $500 ($10,000 \times 5\%) would have the desired effect of relieving C from tax on the $10,000 of gross income expended for business purposes, and it would also cause C and D to pay the same amount of tax. A credit of $500 to A, however, would be inadequate, because the gross income A used to pay his business expenses would be subject to a tax of $1,000 ($10,000 \times 10\%). The $500 credit would leave A paying $500 more in tax than B.

The unfair treatment of A could be solved by granting him a credit of $1,000; extending the $1,000 credit to C, however, would be unfair because it would cause him to pay less tax than D. Of course, a variable credit could be designed to solve the problem, with the amount of the credit increasing with the tax rate. Such a credit, however, would be functionally equivalent to a deduction and would complicate tax computations and disguise the policy function of the allowance.

\textsuperscript{218} \textit{See} Steuerle, \textit{supra} note 10, at 74 (showing a dramatic decline in the value of the dependency allowances since 1948).

\textsuperscript{219} Assuming the family is paying tax at a rate of 10\%, the top marginal rate on personal service income, \textit{see} N.Y. \textit{TAX LAW} § 602(d) (McKinney Supp. 1984-1985), then the two dependency exemptions would generate a deduction of $1,600 and a tax savings of $160. At a 14\% marginal rate, the savings would be $224.

\textsuperscript{220} \textit{See} \textit{supra} note 204.
A substantial increase in the dependence allowances almost certainly is in order. Such an increase, however, might be prohibitively expensive in terms of lost revenue unless the dependency exemption is uncoupled from the other types of exemptions now provided to taxpayers. Because the functions served by the dependency exemptions are distinct from those served by the other exemptions, there is not a good policy reason to make the amount for all of these exemptions the same.

New York’s separate filing system requires rules for determining when someone qualifies as a dependent of the taxpayer. The chief problem is determining which parent is entitled to claim the exemption for a dependent child. The New York State Tax Department, however, cannot rely on the administrative efforts of the IRS to make that determination because the IRS has no reason to allocate dependency exemptions between spouses filing joint returns. The federal government has workable, albeit complex, rules for allocating the exemptions between separated spouses and between divorced persons. New York apparently wants married taxpayers to apply these rules in determining which spouse is entitled to an exemption. The Tax Department, however, cannot enforce such rules at an acceptable cost. As a practical matter, it must tolerate whatever allocation the taxpayers may choose.

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**n** Such exemptions include personal exemptions, exemptions for the blind, and exemptions for those over 65. See I.R.C. § 151 (1982) (granting a personal exemption for the taxpayer and his spouse and additional exemptions for being blind or over 65 years old); N.Y. Tax Law § 616 (McKinney Supp. 1984-1985) (granting a New York exemption for each exemption the taxpayer is entitled to for federal income tax purposes).

**n** There may in fact be good reason to repeal the special exemptions for those over 65 and for the blind. See Congressional Budget Office, Congress of the U.S., Reducing the Deficit: Spending and Revenue Options 207 (1984) (arguing that the blindness and over-65 exemptions do not serve tax policy goals and showing their “upside-down” distribution of benefits). California, which generally follows federal law in allowing personal and dependency allowances, does not grant an extra allowance to those over 65 but does grant an extra allowance to the blind. See supra note 201.


**n** The federal government does not have as much of an enforcement problem as New York because it is concerned with these rules only for the minority of taxpayers who are divorced or separated. Under New York law, the allocation problem arises for all taxpayers claiming an exemption.
2. Income Splitting for Families

Family income splitting — that is, separate taxation of each family member on his or her presumed share of the aggregate family income — is compatible with the benefit principle that underlies the theoretical case for marital income splitting. New York, however, should not seek to extend an income splitting rule to families for two reasons. First, the prerequisite for family income splitting is the aggregation of the individual incomes of the family members. The federal government does not require such aggregation, and the information that New York would need to impose an aggregation requirement on families is not readily available. To require family aggregation in substance as well as in form, New York tax authorities not only would need to combine the Form 1040 incomes of parents and children, but they also would need to bring into the family return the income accruing to family trusts and to legal entities serving a similar tax-shelter function.\(^\text{226}\) Unless and until the federal government adopts a system of family taxation, the administrative costs to New York of traveling that path are probably prohibitive.

A second reason to avoid family income splitting is the difficulty in devising a practical splitting rule that can accommodate the variety of family sharing patterns. Detailed information about how parents and children actually share economic resources is not available, although common experience suggests that family sharing does not fit any simple model.\(^\text{226}\)

The dependency deductions can provide a very crude approximation of the tax benefits of family income splitting without the administrative complications of family aggregation rules.\(^\text{227}\) Assuming that


\(^{226}\) The per capita cost of supporting children tends to go down as the number of children goes up. Parents also report with some regularity that teenagers are more expensive to maintain than babies. Some rough family sharing rules might be devised to take into account the age of children and the number of family members. New York, however, does not have a strong enough policy interest in this complex issue to justify becoming the pioneer supporter of such rules. The Treasury Department has recently suggested that the federal government be the pioneer. It proposes to tax the unearned income of children under 14 years of age at the marginal rate of their parents. \textit{See} 2 U.S. Treasury Dept., \textit{TAX REFORM FOR FAIRNESS, SIMPLICITY AND GROWTH} 92-95 (1984) [hereinafter cited as TAX REFORM FOR FAIRNESS].

\(^{227}\) \textit{See supra} note 215 and accompanying text.
middle- and upper-income families are not able to engage in "self-help" splitting through intrafamily gifts, trusts, and other popular devices, they would not fare as well under a system of dependency deductions as they would with a formal system of family splitting. This is especially true for one-parent families. But dependency deductions can give satisfactory results at low-income levels and, if well-designed, better results at the higher income levels than the practical alternatives.

The present system of per capita deductions is cruder than it need be. Those deductions provide families with approximately the same benefits for each additional dependent, although the tax savings from family income splitting would diminish substantially with each additional dependent even assuming a per capita family splitting formula — the most favorable splitting formula that could be offered. A significantly improved approximation of the distribution of burdens produced by family income splitting could be achieved by abandoning per capita dependency deductions in favor of a generous dependency deduction for the first dependent and a somewhat smaller deduction for each additional dependent. The New York State Tax Department could administer a variable dependency deduction system without substantial difficulty because taxpayers already report the information needed to administer it on their federal Form 1040.

3. Child-Care Credit

In addition to the dependency exemptions, New York grants what is popularly called a child-care credit. The credit, however, is also available to persons with dependents other than children. Those

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228 For example, a dependency deduction of $800 for a New York taxpayer who has income of $50,000 and who is subject to a marginal tax rate of 14% would save the taxpayer $112. A splitting formula that allocated one quarter of the taxpayer's income to his dependent would save the taxpayer $1,750. The dependent would be required to pay New York taxes of $640 on income of $12,500 (assuming no deductions or exemptions of any kind). Thus, income splitting would save the taxpayer $1,110, which is $998 more than he would save from the $800 exemption.

229 See supra note 215 and accompanying text.

230 Some tax jurisdictions permit full income splitting for family members. For example, the French tax system and its progeny throughout the developing world assume that income is shared on a per capita basis with members of the immediate family. See M. NORR & P. KERLAN, TAXATION IN FRANCE §§ 5.4, 12.4 (World Tax Series, International Tax Program, Harvard Law School, 1966).

231 See supra notes 114-18.

232 See I.R.C. § 44(c)(1) (1982) (defining qualified individuals as dependent children under 15, dependents incapable of caring for themselves, and the taxpayer's spouse, if he or she is
with qualified dependents can contract to have the caretaker do housework and other chores in addition to or in lieu of child care.\textsuperscript{233} The child-care credit is a popular feature of both New York and federal law, but the objective it is supposed to serve is unclear.\textsuperscript{234} When the federal income tax law granted a deduction rather than a credit for child-care expenses, the provision was typically defended on the ground that such expenses were a legitimate business expense of working parents.\textsuperscript{235} That rationale, however, was perceived to be inadequate by many observers. Because the decision to have a child is a personal one, the subsequent burdens resulting from that decision arguably are not properly characterized as business expenses.\textsuperscript{236} By converting the allowance to a credit, Congress further weakened the child-care allowance’s business-expense underpinning, since a proper business expense ought to be deductible.\textsuperscript{237}

Congressional support for the child-care credit probably is not based on traditional fairness principles, but rather on the credit’s possible efficiency impact in mitigating the barriers that some parents face in entering the job market.\textsuperscript{238} According to some commentators, the allowance for child care acts as a counter to the tax-free imputed income that parents can obtain from taking care of their own children.\textsuperscript{239} It is unclear, however, how the child-care allowance actually affects economic behavior. Even the direction of its impact is somewhat uncertain, because the allowance, by lowering the out-of-pocket cost of child care and housekeeping, may stimulate parents to consume more of such services than they would in a tax-neutral

\textsuperscript{233} Id. § 44A(c)(2)(A)(i).

\textsuperscript{234} See McIntyre, Evaluating the New Tax Credit for Child Care and Maid Service, TAX NOTES, May 23, 1977, at 7 (explaining the substantial weaknesses in the various rationales offered in support of the child-care allowance).

\textsuperscript{235} For a discussion of the history of the child-care deduction and a criticism of the business-expense rationale for it, see Feld, Deductibility of Expenses for Child Care and Household Services: New Section 214, 27 TAX L. REV. 415 (1972) (contending that child care is a mixed personal and business expense).

\textsuperscript{236} See Feld, supra note 235, at 425-29; see also Arnold, The Deduction for Child Care Expenses in the United States and Canada: A Comparative Analysis, 12 W. ONT. L. REV. 1 (1973) (favoring a credit over a deduction, principally because the credit is a better device for neutralizing the disincentive on working mothers).

\textsuperscript{237} The Treasury Department’s recent tax reform proposal would convert the federal child-care credit into a deduction on the theory that child-care costs are akin to business expenses. See Tax Reform for Fairness, supra note 226, at 17-19.

\textsuperscript{238} See 1981 General Explanation, supra note 32, at 53.

\textsuperscript{239} See generally Schaffer & Berman, Two Cheers for the Child Care Deduction, 28 TAX L. REV. 535 (1973).
environment. The child-care credit provides some marital partners with an incentive to file a joint state return. This incentive arises because New York requires married couples filing separately to take the credit against the tax of the lower-earner spouse. For federal purposes, however, the credit is available under certain conditions even if there is only one income earner. The credit is available to one-job families, for example, if the nonworking spouse is a student or is incapacitated. Taxpayers who receive the federal credit in situations where only one spouse works cannot claim the state credit unless they file joint New York returns.

The New York child-care credit reinforces the modest federal incentive to purchase paid babysitting services in the marketplace rather than to make informal arrangements with friends and relatives. The New York credit is unlikely to reduce significantly the work disincentive that confronts some parents because of their child-care responsibilities. A decision to enter the job market, if affected at all by tax considerations, is much more likely to be affected by the federal personal income tax than by the state’s personal income tax. At the state level, the incentive and disincentive effects of the child-care credit are probably trivial, especially after considering that reductions in state taxes are partially offset by increases in federal income taxes for those who itemize their federal deductions.

4. Higher Education Expenses

New York’s deductions for higher education expenses are difficult to defend under any tax policy criteria. Because the deductions were enacted not to achieve tax policy goals but rather to make it easier for parents to provide higher education for their children, they

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240 A child-care allowance might be defended on fairness grounds as an indirect mechanism for taxing parents on imputed income that results from their enjoyment of above-average amounts of self-performed child-care and household services. See Coven, supra note 10, at 1552-53 (favoring a liberalized child-care and household service allowance for single workers and for two-job couples). Apparently, the only justification for the allowance for maid service is based on the imputed income argument. The imputed income argument logically leads to a recommendation for granting the child-care allowance to all persons with below-average amounts of self-performed child-care services — most notably persons without children. See McIntyre & Oldman, supra note 15, at 1619-20.

241 See supra note 116.


243 By filing a New York joint return, married couples are entitled to report their joint taxable income. See N.Y. TAX LAW § 611(b)(2)(A) (McKinney 1975).
should be subjected to a tax expenditure analysis.\textsuperscript{244} Such an analysis exposes their "upside-down" or regressive subsidy effect. For example, as a result of the graduation of state income tax rates, the maximum $1,000 tuition deduction claimed by a taxpayer in the top fourteen percent bracket saves the taxpayer $140 in taxes, whereas the same deduction by a taxpayer in the bottom two percent bracket is worth only $20. Persons who are outside of the income tax system, either because they are too poor to pay tax or because all of their income is exempt, receive no benefit from the deduction.

The use of the state tax system to encourage savings for education is inherently inefficient because New York taxpayers who itemize their federal personal deductions pay higher federal income taxes as a result of the reduction in their state taxes.\textsuperscript{246} For a taxpayer in the fifty percent federal marginal tax bracket, the maximum $140 of state tax savings that results from the $1,000 deduction increases the taxpayer's federal taxes by $70 ($140 x 50\%). The state thus forgoes $140 in revenue to grant the taxpayer $70 of benefit.

Compared with the cost of higher education, the net out-of-pocket savings to a taxpayer from the education deductions are so small that they will not have any significant impact on the ability of parents to send their children to college.\textsuperscript{246} The deductions, however, still cause a loss in state revenue and impose an administrative burden on the Tax Department.

The regressive effect of the education deductions could be remedied by converting the deductions to refundable tax credits. That change by itself, however, would not guarantee the acceptability of tax allowances as spending programs. Nor would it eliminate the inefficiency that arises from an increase in a taxpayer's federal income taxes. Much of that inefficiency might be eliminated, however, if the revenue lost through forgone taxes were spent directly by the state to provide deserving students with scholarships, because scholarships generally are not taxable by the federal government.\textsuperscript{247}

\textsuperscript{244} Provisions in a tax statute that seek to achieve traditional spending goals should be analyzed as tax expenditures. See McIntyre, supra note 210, at 83-86.

\textsuperscript{246} The United States Treasury Department has recently proposed the elimination of the deduction for state and local taxes. See Tax Reform for Fairness, supra note 226, at 62-68. Adoption of the Treasury Department's proposal would eliminate the inherent inefficiency of state deductions, but it would do nothing to cure the other defects of the education tax subsidies.

\textsuperscript{246} For a taxpayer in a 50\% federal tax bracket who itemizes deductions, the net savings from the maximum deduction of $1,000 equals $70 ($1,000 x 14\% x 50\%).

\textsuperscript{247} Scholarships to pursue a college degree generally are exempt from federal income tax. See I.R.C. § 117(a) (1982).
The higher education deductions have no federal counterpart and must be administered by the New York authorities without any federal assistance. Both deductions are reasonably difficult to administer if the Tax Department attempts to verify the information that taxpayers report on their tax return. The deduction for contributions to educational trust funds is particularly difficult to administer. It requires a policing of the educational trust funds and an assessment of tax on student beneficiaries after they graduate. The latter problem is particularly great if the trust beneficiary becomes a nonresident after graduation.

IV. A Program for Reform

The preceding sections of this Article analyzed the existing system of family taxation in New York, identified its major weaknesses, and explored possible remedies. This section of the Article sets forth a set of concrete recommendations for reform.

A. Statement of Goals

1. Conflicts Among the Asserted Criteria of Family Taxation

When discussing the federal taxation of families, many commentators have suggested that an ideal income tax should be progressive, should impose equal taxes on equal-income married couples, and should be marriage neutral. As most commentators now recognize, no income tax can satisfy all three criteria. This inherent incom-

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248 See, e.g., Bittker, supra note 11, at 1395-97; Gann, supra note 9, at 9-10; Rosen, supra note 19, at 423.

249 The proof of this simple proposition first appeared in testimony delivered by Edwin S. Cohen, Assistant Secretary of the Treasury for Tax Policy. See Tax Treatment of Single Persons and Married Persons Where Both Spouses Are Working: Hearings Before the House Comm. on Ways and Means, 92d Cong., 2d Sess. 73-95 (1972); see also Bittker, supra note 11, at 1395-97. For a formal proof of the proposition, see McIntyre & Oldman, supra note 15, at 1591.

One commentator purports to show that all three criteria could be achieved in a "negative income tax." See Lovell, On Taxing Marriages, 35 Nat'l. Tax J. 507 (1982). Lovell's proposed negative income tax would have two taxable units — the class comprised of unmarried persons and the class comprised of married couples. All taxable units would pay tax at a flat rate, although they would also be entitled to a refundable, lump-sum tax credit. Because of the credit, the tax would be mildly progressive. The credit for married couples would be double that granted to single persons. Employing some simple algebra, Lovell shows that the aggregate of the taxes on two unmarried individuals would neither increase nor decrease if they were to marry. Id. at 507-08.
patibility is cause for rethinking the merits of the three criteria and for rejecting one or more of them, because family taxation rules designed according to logically inconsistent criteria are destined to be complex, ineffective, and unprincipled.

A restatement of the three criteria listed above exposes the source of the conflict among them. The first criterion is a controversial but defensible principle of distributive justice. Commentators frequently call it the principle of vertical equity. It asserts that the burdens of the income tax should be imposed so that the after-tax distribution of income, broadly defined to include all economic gain, is more equal than the before-tax distribution. This redistributive goal can be achieved through graduated rates, through low-income deductions or exemptions, through tax credits (either granted to all taxpayers or to those in low-income brackets), or through some combination of these techniques.

The second criterion is not properly called a principle of taxation, because there is no a priori reason why two married couples should pay the same amount of tax simply because they have the same total income. The case for equal treatment of equal-income couples depends upon an empirical finding that marital partners typically pool their incomes or otherwise enjoy comparable standards of living. Given that factual premise, however, the second criterion follows logically from two defensible principles of taxation — the horizontal equity principle and the benefit principle.

The horizontal equity principle states that individuals in the same economic position, as measured by their taxable income, should pay

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Whether Lovell’s proposed tax is properly classified as marriage neutral depends upon how that term is defined. If neutrality is defined in terms of the aggregate of the taxes imposed on two individuals before and after their marriage, then Lovell’s tax obviously is marriage neutral. If, however, neutrality is defined in terms of the impact of marriage on an individual taxpayer, Lovell’s tax is not marriage neutral. Consider, for example, two unrelated single persons, M and F. Assume that M is subject to a tax of $50 and F is subject to a tax of $30. Now assume that M and F get married. After marriage, the couple will be subject to a tax of $80 under Lovell’s scheme. The burden on each spouse, however, is indeterminate, absent some knowledge of their sharing practices. If the spouses pool benefits and burdens, each presumably will bear a tax of $40. Under that assumption, neither Lovell’s tax nor any income tax, progressive or proportionate, that made the tax on two marital partners a function of their aggregate income would be marriage neutral.

More fundamentally, Lovell’s negative income tax is actually two analytically distinct proposals — a proposal for a mildly progressive positive income tax and a proposal for a system of transfer payments to individuals, rich or poor, who have little or no income during the taxable period. The part of Lovell’s negative income tax that provides transfer payments is properly characterized as a tax expenditure. The part that constitutes a true tax is not marriage neutral.

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the same tax. Its core content is somewhat indefinite, and, perhaps for that reason, it is widely accepted.

The benefit principle asserts that individuals should be ranked for horizontal equity purposes according to the income they actually enjoy. In a society in which marital partners typically pool their resources, the benefit principle requires wives to be ranked the same as their husbands for horizontal equity purposes. Because the horizontal equity principle ranks taxpayers according to the taxable income attributed to them, and because marital partners who pool should be ranked the same, it necessarily follows that the rules for determining an individual's taxable income should be constructed to give marital partners who pool the same taxable income. It also follows that equal-income married persons would pay equal taxes. In such a tax system, equal-income couples necessarily would pay equal taxes.

The third criterion — marriage neutrality — is usually understood to mean that two single persons should not experience a change in their aggregate tax liability if they get married. This criterion is also not properly termed a principle of taxation, since there is no a priori reason for believing that the rules specifying the conditions for horizontal equity would ignore the economic consequences, if any, that typically accompany marriage. In fact, the empirical finding that would be required to square the third criterion with the benefit principle and with the horizontal equity principle is directly contrary to the empirical finding that underlies the second criterion. That is, marriage neutrality is a proper goal only if marriage typically is not accompanied by a tax-relevant change in the economic condition of the newlyweds. But if such a change typically does not occur, then there is no good reason to advocate equal treatment of equal-income married couples.

Once the source of the conflict among the three criteria is understood, the grounds for choosing among them becomes clear. Commentators are logically required to reject marriage neutrality as a criterion for the design of family taxation rules if they accept the benefit principle and also accept the empirical proposition that marital partners pool resources. Consequently, those who wish to make marriage neutrality a criterion for tax design must deny that marital partners

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282 Id.
283 See supra note 15 and accompanying text.
284 For an example illustrating why equal treatment of marital partners produces equal treatment of equal-income couples, see supra note 167.
typically pool resources, or they must develop an income attribution principle under which the benefits lost and gained from income pooling are irrelevant to the specification of an individual's taxable capacity. No one has yet made a serious attempt to develop such a principle.

2. Goals for New York

The goals proposed for the New York personal income tax should be internally consistent and sufficiently concrete to provide real help to policymakers in designing an income tax. The following five goals satisfy these criteria. The last three goals are a restatement of what the staff of the Tax Study Commission perceives to be an emerging tax policy consensus in New York. The first two are more controversial.

a. Goal One: Implement Benefit Principle of Income Attribution

All individuals, married or single, should be taxed on the economic gains they enjoy during the taxable year, without regard for the source of those gains. In other words, New York should seek to implement the benefit principle of income attribution.

b. Goal Two: Enhance Administrative Efficiency

For administrative reasons, New York should avoid enacting or retaining any tax provision that depends for its enforcement on the Tax Department developing information sources independent of the IRS enforcement machinery unless the state has substantial, overriding policy reasons for enacting such a provision. In the area of family taxation, no such state policy reasons have been detected.

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335 The control principle, implicitly invoked by individual filing advocates in support of their position, is not compatible with marriage neutrality. It requires for its implementation that marital income splitting devices be thwarted, which is not possible without rules that depend for their application upon the existence of a marriage.

336 See McIntyre, supra note 10, at 474-76 (explaining the difficult preconditions for a viable defense of an alternative to the benefit principle).

337 The first two goals have been defended in detail supra notes 128-247 and accompanying text.
c. Goal Three: Exempt Poor from Taxation

Individuals and families who are poor by community standards should not be required to pay any income tax. This goal is a narrow restatement of the goal of progressivity that New York and the federal government have long embraced. The most widely accepted measure of community standards of poverty is the federal poverty level figures published annually in the Statistical Supplement to the Social Security Bulletin.\(^{258}\)

The federal poverty level figures reflect estimates of average need for households of one and more members. Abstracting the subsistence needs of single individuals from the federal poverty figures is problematic, since many single persons are members of households with more than one member. The federal poverty figures indicate that the per capita subsistence needs of a two-person household are less than the per capita needs of a one-person household.\(^{260}\) It does not necessarily follow, however, that single persons typically have greater per capita subsistence needs than married persons.

In fixing tax-free amounts, New York should be particularly sensitive to the needs of one-parent families. In theory, an income splitting approach would give significant benefits to a single parent sharing income with a child. New York, however, cannot grant income splitting benefits to families.\(^{260}\) Low-income relief, therefore, must play an important role in mitigating the burdens otherwise imposed on one-parent families of modest means.

d. Goal Four: Enhance Ease of Taxpayer Compliance

The New York tax return should be simple enough that taxpayers whose income comes chiefly from wages and who do not engage in complex financial transactions can themselves correctly complete their state return once they have completed their federal return. To achieve this goal of simplicity and clarity, New York must forgo some of the distinctions that would follow from a finely tuned sense of equity. A good approximation of equity is a worthy goal, especially for a tax jurisdiction like New York that does not employ high marginal tax rates.

\(^{258}\) See supra note 189.

\(^{260}\) See supra note 189.

\(^{260}\) See supra notes 225-26 and accompanying text.
e. Goal Five: Illuminate Underlying Policy

New York should employ tax techniques that illuminate the fundamental policy decisions incorporated into the tax system. It should avoid clever devices that obfuscate such decisions. An income tax is a political instrument, and ultimately it should reflect the fundamental value judgments of an informed public. The popular support that is crucial for a political commitment to a fair income tax is undermined when the goals the income tax should achieve are obscured.

B. Joint Returns with Full Income Splitting

New York should adopt a joint return system that treats each spouse as the taxpayer on one half of the couple's total income. The least disruptive technique for achieving full marital income splitting in New York would be to make income splitting elective for marital partners who are both residents of New York. Spouses electing to file jointly would each pay tax on one-half of the total marital income according to the same rate schedule applicable to unattached individuals. As explained in section III above, adoption of full income splitting would implement the benefit principle of income attribution, enhance the efficiency of the Tax Department, foster easier taxpayer compliance, and illuminate the underlying policy of the tax system.

C. A Unified Low-Income Allowance

In order to simplify its tax structure and provide adequate low-income relief to individuals and family members, New York should merge all of its existing low-income relief measures into one low-income allowance. The merged allowance would replace the personal exemptions for a taxpayer and his spouse, the household credit, the low-income exemptions, and the minimum standard deduction. New York should maintain, however, the exemption for dependents. The amount of the unified allowance would be the same, on a per capita basis, for single persons and married persons. Thus married persons filing jointly or separately would obtain, in total, twice the low-in-

\[361\] See supra notes 128-43 and accompanying text.
\[362\] See supra text accompanying notes 14-15.
\[363\] See supra text accompanying notes 170-73.
\[364\] See supra text accompanying notes 162-69.
come relief granted to single persons. The head of a one-parent household, however, would receive a low-income allowance that exceeds the per capita relief given to single persons without children and to married persons.

The actual amounts of low-income relief granted would depend upon revenue constraints and upon other changes that may be made as part of a comprehensive reform in the existing tax rate structure, the standard deduction, and the tax base. The amount of relief granted a single person not claimed as a dependent by his parents cannot reasonably be below the federal poverty level for one-person households. Providing equal per capita relief to married persons, therefore, would allow some couples just above the federal poverty line to pay no New York taxes.265

Implementation of the unified low-income allowance would not necessarily require repeal of the personal exemption. If the personal exemption is continued, then the per capita low-income relief should be reduced by the amount of the exemption.

New York would obtain, however, two advantages from repeal of the personal exemption. First, repeal would necessarily sever the tie between the personal exemption and the dependency exemption. The dependency exemption and the personal exemption serve related but nevertheless separate functions in an income tax. The personal exemption contributes to the exclusion of poor individuals from taxation and provides those above the poverty line with a reduction in their effective tax rate.266 The dependency exemption contributes to low-income relief for families and provides a rough approximation of the benefits that families would obtain if family members were permitted to split their combined incomes. Only by happenstance would

265 The following schedule illustrates a minimum acceptable level of low-income relief for households of different composition: (1) $1,500 for single persons who are claimed as a dependent by another taxpayer; (2) $5,000 for unattached individuals without qualifying dependents and married persons filing separately; (3) $10,000 for married persons filing jointly, the $10,000 divided equally between the spouses ($5,000 for each spouse); and (4) $7,000 for persons with qualifying dependents who file their federal tax return as a head of household or a surviving spouse. The justification for extending head of household status to surviving spouses with qualifying dependents is explained supra note 205.

266 The personal exemption is best understood as being a part of the rate structure, because it is granted to achieve a desired distribution of burdens rather than to measure an individual's material well-being. Some commentators, however, treat the personal exemption as a horizontal equity rule. They assert that a proper tax base should be defined in terms of "discretionary income," meaning income above an amount necessary for basic subsistence. For a discussion of the discretionary income concept and its implications for rate relief, see Feld, supra note 189, at 434-36, 448-49 (favoring the concept of discretionary income but implicitly acknowledging that it serves a vertical equity function rather than a horizontal equity function).
the appropriate level for the dependency exemption be the same as the appropriate level for the personal exemption. Separating the two types of exemptions in the public mind would give policymakers greater freedom to structure the dependency allowances to achieve their intended goal. More specifically, the replacement of the personal exemption with more explicit rate relief would facilitate the adoption of variable dependency exemptions. A second reason for favoring repeal of the personal exemption is the simplification of calculations that taxpayers would gain while computing their New York tax liability. As long as the amount of the personal exemption and the dependency exemption are the same, the simplification gains from repeal of the personal exemptions probably would be modest. Those gains, however, would be much greater if conformity of the personal exemption with the dependency exemption is abandoned.

The proposed low-income allowance, in conjunction with the dependency exemption, would exempt from taxation all individuals and all families below or near the federal poverty level. It would also eliminate the marriage penalty that middle- and upper-income couples currently bear because of the cap on the percentage standard deduction.

Like the existing minimum standard deduction and the household credit, the proposed low-income allowance should be phased out for middle- and upper-income taxpayers. A simple phase-out could be accomplished by making the low-income allowance an alternative to the percentage standard deduction, thereby continuing the policy of current law of reducing the benefits that some low-income taxpayers otherwise might gain from the itemized personal deductions. With

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267 See infra notes 280-82 and accompanying text (recommending adoption of the variable dependency exemptions).

268 A recommendation for a variable dependency exemption is made infra notes 280-82 and accompanying text.

269 The percentage standard deduction is $2,500 for a single person and for two married persons, whether they file jointly or separately. See N.Y. Tax Law § 614(a) (McKinney Supp. 1984-1985) (limiting the standard deduction to $2,500 for single persons and married persons filing jointly); id. § 614(b) (limiting the total standard deduction to $2,500 for marital partners filing separately, but authorizing spouses to divide the deduction between themselves as they wish).

270 The federal government uses the standard deduction as a low-income relief mechanism and as a substitute for the itemized deduction. For a criticism of that policy, see Feld, supra note 189, at 440-41, 455-56. Having the standard deduction do double duty as both the low-income relief mechanism and the substitute for itemized deductions presents less of an equity problem at the state level than at the federal level because low-income taxpayers who do not itemize on their federal return are not eligible to itemize on their state return due to administrative constraints. If New York repeals most itemized deductions and repeals the standard deduction, then taxpayers should be permitted to claim the new low-income allowance and to
the percentage standard deduction currently set at seventeen percent of adjusted gross income, the phase-out would be complete at $29,412 for taxpayers filing separate returns\textsuperscript{271} and at $58,924 for married couples filing jointly.\textsuperscript{272} So gradual a phase-out may produce an unacceptable revenue loss. Certainly if the standard deduction is reduced sharply as a result of a reform of the New York tax base, then some alternative phase-out technique must be adopted. If the percentage standard deduction is repealed, then New York might adopt the California model by structuring its low-income relief in the form of a vanishing credit.\textsuperscript{273}

As a correlative adjustment to its substantial expansion of low-income relief, New York also should eliminate the bottom two brackets (two percent and three percent) in its rate schedule and expand the width of the third bracket (four percent) to make it the first marginal bracket on the rate schedule. In effect, the first two brackets would become a part of the zero-bracket amount provided by the low-income allowance. These rate changes would serve to recoup some or all of the tax reductions otherwise enjoyed by moderate- and upper-income taxpayers from the proposed expansion of low-income relief. If some relief to those classes of taxpayers is proper for reasons not germane to the issues addressed in this Article, it should be granted by adjusting the rate at which the low-income allowance is phased out or by not phasing out the low-income allowance at all.

Granting a comparatively modest low-income allowance to individuals claimed as dependents would continue and extend the household credit's underlying policy of not treating dependent single individuals as poor.\textsuperscript{274} The low-income allowance should be somewhat less generous than current law,\textsuperscript{275} which exempts individuals claimed as a dependent from taxation on their first $2,500 of income.\textsuperscript{276} A less generous allowance for dependent children would reduce the advantage that parents currently obtain from shifting property income to their

\textsuperscript{271} For a single taxpayer with income of $29,412, a percentage standard deduction of 17% would be worth $5,000 of tax savings, which is equal to the proposed low-income allowance for single persons not claimed as a dependent.

\textsuperscript{272} For a married couple filing a joint return with combined income of $58,924, a percentage standard deduction of 17% would be worth $10,000 of tax savings, which is equal to the combined low-income relief of the marital partners. The $7,000 low-income relief for one-parent families would be phased out completely at an income level of $41,176.

\textsuperscript{273} For a brief description of the California system, see supra note 201.

\textsuperscript{274} See supra note 111.

\textsuperscript{275} The low-income allowance recommended by this Article is $1,500. See supra note 265.

\textsuperscript{276} See supra notes 102-04 and accompanying text.
children, but it would permit children to earn modest amounts from paper routes and similar jobs without being subject to the state income tax.

This recommendation, if adopted, would advance all of the goals proposed by this Article for the New York personal income tax, but especially the goals of exempting the poor from taxation and of fostering easier taxpayer compliance. The simplification gains for low- and moderate-income taxpayers would be dramatic. Those with incomes no greater than the tax-free minimum could determine their tax-free status at a glance. Now they must compute their tentative, pre-credit tax and their household credit before determining whether they are exempt — a cumbersome series of calculations imposed on persons who may be unable to cope well with complexity. The simplification gains for those with incomes above the tax-free minimum would also be significant, especially if the Tax Department prepared tax tables that incorporated the low-income allowance and the phase-out mechanism.

D. Expanded Dependency Deductions

The existing $800 dependency exemption should be replaced with a dependency exemption of $1,500 for the first dependent and an exemption of $1,000 for each additional dependent. The New York definition of "dependent," which incorporates by reference the federal definition, should be continued.

A major increase in the amount of the dependency exemption is needed to provide reasonable relief to those who are sharing income with their children or other dependents. The present exemption provides almost no differentiation in the burdens borne by two-person families and by equal-income married couples without children. It also gives inadequate relief to one-parent families of modest means. Granting greater tax relief for the first dependent would provide a better approximation of the consequences of family income splitting than the per capita exemption of current law. In addition, a relatively large exemption for the first dependent would reduce the difference in tax burdens imposed on married couples without children.

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277 At the federal level, the zero-bracket amount is not available to dependent children with respect to unearned income. See I.R.C. § 63(e)(1), (2) (1982).
278 See supra notes 248-60 and accompanying text.
279 See supra notes 102-13 and accompanying text.
280 See supra note 92 and accompanying text.
281 See supra note 230 and accompanying text.
and on heads of households with one dependent, especially at low-income levels. The elimination of all differences between the tax burdens imposed on one-parent families with one child and those imposed on childless married couples may not be justified, especially at middle- and upper-income levels. Family members other than spouses are not required to aggregate their individual incomes, and the degree of sharing within one-parent families is not known. The lower exemption for additional dependents is consistent with the federal poverty level figures. This recommendation, if adopted, would implement the benefit principle of income attribution and would exempt the poor from taxation.

E. Education and Child-Care Costs

The deductions for tuition payments and for contributions to a qualified higher education trust fund are inefficient tax preferences that should be repealed. The proposed increase in the dependency exemption, if adopted, would provide relief to families almost as great as that provided by the education deductions, but without the unfairness and the administrative burdens. Adoption of this recommendation would enhance the Tax Department's efficiency and foster easier taxpayer compliance.

The state also should consider repealing the child-care credit. The credit has some merit, although all of the arguments made on its behalf have important weaknesses. Repeal would foster easier taxpayer compliance, and would help to illuminate underlying policy, although not dramatically. Because of the potential hardship that repeal might cause for one-parent families of modest means, a decision to repeal should not be made unless the other measures recommended in this Article for the relief of one-parent families are adopted.

Conclusion

New York has a separate filing system in form, but not in reality. The reality is a complex hybrid of joint and separate filing features.

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See supra note 189 (showing that the increase in per capita subsistence needs is greater for the addition of the first child to a family than for subsequent additions).

For an analysis of the arguments made on behalf of the child-care credit, see supra notes 231-43 and accompanying text.
Under current New York practice, the attribution of investment income between spouses is largely elective, at least for the well-informed. Shifting itemized deductions is specifically sanctioned in the New York tax code. Wages generally are taxable to the wage earner, although wages can be shifted through alimony payments and, in limited cases, through the use of family partnerships and corporations. Low-income relief is designed to take into account traditional family sharing practices, but the mechanisms for delivering that relief, including an elective joint return, are needlessly complex. No theory of income attribution can justify this patchwork pattern.

Purging New York’s separate filing system of its joint filing elements is administratively impossible, given the practical dependence of the New York Tax Department on information supplied by the IRS. Even if separate filing could be enforced, it would not produce the “marriage neutral” system envisioned by its supporters because transfers that unquestionably would have economic substance when entered into between strangers require special scrutiny when entered into between members of an on-going marital partnership. It is also unlikely that New Yorkers would endorse a system of low-income relief that ignored an individual’s family circumstances.

The trend in recent years has been to increase rather than repeal the joint filing elements of New York law. New York has added two more joint filing features to the existing hybrid in the past year—the Individual Retirement Account (IRA) deduction for a dependent spouse and the exclusion of a portion of unemployment compensation attributable under federal tax rules to the nonearning spouse. Both changes offend the ideology that underlies the separate filing rule. They are, however, probably harbingers of the future, for it is naive to suppose that New York will endorse provisions of federal law that deny or restrict benefits to separate filers as an incidental side-effect of provisions designed for married couples filing jointly.

The simplest and fairest way for New York to obtain a coherent

\[\text{footnote 284} \text{ Canada has a separate filing system and, unlike New York, it makes a serious effort to block “self help” income splitting. To that end, its Income Tax Act taxes transferors on income, gain, or loss arising from property transferred from one spouse to another. Income Tax Act, Can. Rev. Stat. ch. I-5, § 23 (1970). Until recently, Canada had a rule prohibiting a deduction for wages paid to a spouse. That rule was widely criticized on the ground that it produced a “tax on marriage,” although its obvious purpose was to prevent a marriage bonus. In 1980, the rule, found in former § 74(5) of the Statutes of Canada was repealed, along with a few other marital income attribution rules. See Act of Feb. 26, 1981, ch. 48, § 40(1), 1980-1983 Can. Stat. 1373.}
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\[\text{footnote 285} \text{ See supra note 180.}
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\[\text{footnote 286} \text{ See supra note 180.}
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system of family taxation would be to repeal the separate filing features of current law. Under the proposed reform, all individuals, married and single, would pay tax under the same rate schedule as is done currently. Married persons would compute their individual taxable incomes, however, by aggregating their income with that of their spouse, subtracting allowable deductions, and dividing the result by two.

The change to an income splitting system is technically easy, but major tax reform is a political issue of the first magnitude, and the political obstacles to income splitting are difficult to assess. Based on an analysis of interests, opposition might be anticipated from single persons, from that relatively small group of marital partnerships in which each of the spouses has substantially equal earnings, and from those couples now enjoying the benefits of “self-help” income splitting.

In the context of a general reform of the personal income tax, however, single persons, as a group, are not likely to have their tax liabilities increase, because they are likely to benefit disproportionately in low-income relief measures, in special relief for one-parent households, and in a curtailment of tax preferences.\(^{887}\) In a revenue-neutral tax reform, members of the other two groups almost certainly will pay higher taxes on average, but a restructuring of the rate schedule and a curtailment of preferences will give a net benefit to at least some members of those groups. The large group of two-earner couples in which the division of income is not substantially equal will probably experience little gain or loss from a comprehensive reform unless they are enjoying above average benefits from preferences.

Married couples with a single breadwinner generally will obtain a relative benefit from income splitting. Those just above the poverty line are likely to experience a dramatic percentage reduction in their tax liabilities, although the dollar reductions, in absolute terms, will be modest. The impact of income splitting on one-income couples in the middle- and upper-income levels will depend on their present consumption of tax preference benefits.

Some political opposition to income splitting may come from those who perceive a joint filing rule as a perpetuation of outdated views on the proper role of women in society. In form, the joint filing rule applies to all married persons, without reference to their sex or their

\(^{887}\) An analysis of federal law, using the Brookings Institution federal tax data, demonstrated that a return to full income splitting would have little or no impact on the bulk of single individuals if coupled with comprehensive reform of the tax base. The key base adjustment was the elimination of homeowner preferences. See McIntyre & Oldman, supra note 199, at 230-34.
work situation. Some commentators contend, however, that in substance a joint filing rule treats wives as adjuncts of their husbands. That contention is not well-founded, at least in the case of joint filing with full income splitting. Any measure that informed people interpret as a slight to one sex or the other, however, will be and should be treated with apprehension by politicians. The image of joint filing has not been helped, moreover, by its implementation at the federal level, with its infamous marriage penalty. Furthermore, the image of individual filing has received an entirely unwarranted boost by its billing as a potential remedy to that penalty.

A helpful development in improving the image of the joint filing rule in some quarters is the recent adoption in New York of the equitable distribution doctrine to govern marital property settlements upon divorce. Separate filing advocates are required to take the position that ownership rights of spouses have fundamental importance, sufficient to justify differences in the burdens imposed upon married couples with equal incomes. That position has little merit when applied to the portion of income that is currently consumed, because ownership rights in spent resources are surely illusory. But the position is a serious one as to saved resources. As long as the saved resources remain unspent, there always remains the possibility that the spouse with the enforceable property right will become the sole beneficiary of that income.

Now that New York has adopted the principle of equitable distribution, however, legal title has a substantially reduced role in determining which spouse will control the disposition of marital property. More importantly, the politics leading up to the adoption of equitable distribution have legitimized the view that New York should treat marriage as a true economic partnership. In large part, the case for marital income splitting is an application of that view.

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A. An income splitting regime makes the well-being of the individual spouse the focus for horizontal equity. See supra notes 14-15 and accompanying text. Joint filing without income splitting, however, is functionally equivalent to the taxation of one spouse, perhaps the husband, on the total income of the marital partners.

B. For a discussion of New York's adoption of the equitable distribution doctrine, see supra note 38.

C. Congress reaffirmed its view of marriage as an economic partnership in the Retirement Equity Act of 1984, Pub. L. No. 98-397, §§ 103, 203, 98 Stat. 1426 (to be codified at I.R.C. §§ 401, 417). The Act gives the spouse of an employee certain rights to the employee's pension, the most significant being the right to survivor benefits. See S. Rep. No. 575, 98th Cong., 2d Sess. 1, 12, reprinted in 1984 U.S. Code Cong. & Ad. News 2547, 2558 ("[B]ecause the committee believes that a spouse should be involved in making choices with respect to retirement income on which the spouse may also rely, the bill requires spousal consent when a participant elects not to take a survivor benefit.").
Ultimately, the political fortunes of a joint return approach to reform will depend upon the positive contributions of that approach to a fair and simple income tax. This Article has demonstrated that those contributions are substantial.\textsuperscript{281} Ideally, New York should provide married persons and heads of household with the same per capita low-income relief now afforded to single persons, and it should eliminate the "income-source" penalties now borne by marital partners with uneven income splits. Taking families below the poverty line off the tax rolls and mitigating the income-source penalties, however, would dramatically increase the fairness of the current system, and would lay a solid foundation for future reform. Nevertheless, such piecemeal revision of current law will not yield substantial simplification gains, except for low-income taxpayers. For a truly simple and fair income tax, New York must include an income splitting election in its reform package.

\textsuperscript{281} See supra notes 128-82 and accompanying text.