TAX JUSTICE FOR FAMILY MEMBERS AFTER NEW YORK STATE TAX REFORM

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Through tax reform acts adopted in 19851 and 1987,2 New York has fundamentally altered its system of family taxation. Prior to the reform acts, the New York personal income tax employed a quixotic mixture of separate and joint filing provisions to adjust tax burdens imposed on individuals. Its relief mechanisms for low-income families were complex and inadequate. Its separate filing rule was impossible to administer fairly and imposed unjustifiable penalties on marital partners who earned substantially unequal incomes. Single parents with dependent children were taxed far more heavily than their economic condition warranted.

The reformed system, when fully effective after 1990, will provide simple and fair tax relief to the poor and will impose substantially equal tax burdens on family members enjoying comparable standards of living. By any reasonable standard, the reform should be judged a success.3

Part I of this Article summarizes the recommendations for reform of New York's system of family taxation set forth in a report of the Staff of the Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law.4 That Commission, popularly referred to as the Tax Study Commission, was established by the New York Legislature in 1981 to review the entire New York tax structure and to offer proposals for reform.5 A revised

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3 Commentators who disagree with the goals of the New York tax reform can complain because the reform achieved those goals. Once the goals of a reform are set, however, the only reasonable standard for evaluating its success is in terms of the progress made in reaching the established goals.


version of the Staff report on family taxation appeared in a prior volume of this Review.6

In part II, the system of family taxation adopted by the 1985 and 1987 tax acts is discussed. The needs for further reform are addressed in part III. Those needs are modest, due to the remarkable progress that has been made in reforming the New York personal income tax system since the establishment of the Tax Study Commission.

I. RECOMMENDATIONS OF THE STAFF OF THE TAX STUDY COMMISSION

Over the past two decades, many tax analysts have made proposals for reform of the federal system of family taxation that were grounded on logically incompatible goals. On the one hand, commentators have taken the position that a personal income tax should adjust tax burdens for the real changes in an individual’s economic condition that typically accompany marriage.7 On the other hand, they have asserted that the tax system should be marriage-neutral.8 Being unwilling to abandon either goal and being unable to reconcile the unreconcilable, these analysts have advocated a set of reform proposals that lacked coherence.9

Commission was chaired, until his retirement from the Assembly in 1987, by Daniel B. Walsh, Majority Leader of the Assembly. The current chairman is Saul Weprin, Chairman of the Ways and Means Committee. The first Director of the Commission, responsible for the preparation of the Staff reports, was Richard D. Pomp. He was succeeded in 1987, after passage of the TRRA of 1987,9 supra note 2, by Robert Plattner, former Counsel to the Commission.

6 See McIntyre, Tax Consequences of Family Sharing Practices Under New York Law: A Critique and A Proposal for Reform, 49 ALB. L. REV. 275 (1986). That Article was not published under the auspices of the Tax Study Commission and does not necessarily reflect its views. Its author, however, was also the principal author of the Staff report. Because that Article is more widely available and because it was updated to reflect some minor changes in the positions of the Staff, its statement of the goals and proposals for tax reform will be cited in this Article.

7 For a review of the literature, see McIntyre, supra note 6, at 281-282.


9 For analysis of the incompatible goals often advocated by tax analysts and for citations to the tax literature, see McIntyre, supra note 6, at 337-40.
The Staff of the Tax Study Commission\(^\text{10}\) did not repeat the mistake of adopting incompatible goals. It took the position that “family taxation rules designed according to logically inconsistent criteria are destined to be complex, ineffective, and unprincipled.”\(^\text{11}\) The proposals it advanced for the reform of the New York system of family taxation were designed to achieve five compatible policy goals.\(^\text{12}\) Those goals are described in section A. The proposals designed to achieve those goals are described in section B.

A. Statement of Goals

At the most general level, an income tax system has three widely acknowledged goals. It should be fair, it should be simple to administer, and it should promote, or at least not impede, economic efficiency. These classic goals are sometimes useful for organizing tax policy debates, but they provide almost no guidance to policymakers in resolving those debates. To be useful, policy goals must embody some choices among competing values. The policymakers must make specific the concept of fairness that they believe the tax system should pursue. They must also make clear the relative weights to be given to fairness, administrative economy, and efficiency criteria in the design of an income tax.

The goals established by the Staff of the Tax Study Commission are broad enough to serve as organizing principles for a tax reform plan and concrete enough to give guidance to analysts in formulating that plan. Like all concrete goals, they are to some degree contentious. Only the first two, however, provoked any controversy during consideration of the Staff’s proposals.

The goals described below balance fairness goals with the constraints imposed by the need for administrative economy. No weight was given to efficiency considerations because the Staff of the Tax Study Commission determined that its recommendations were unlikely to have significant efficiency implications.\(^\text{13}\)

\(^{10}\) References hereinafter to the Staff are references to the Staff of the Tax Study Commission.

\(^{11}\) McIntyre, supra note 6, at 338.

\(^{12}\) Id. at 340-42. For the Staff’s concrete reform proposals, see id. at 342-47.

\(^{13}\) Some commentators have suggested that the federal joint filing rule imposes some efficiency costs on society. See, e.g., Gann, Abandoning Marital Status as a Factor in Allocating Income Tax Burdens, 59 Tex. L. Rev. 1, 39-46 (1980); see also McIntyre, supra note 6, at 309-11 (discussing merits of efficiency argument and citing additional relevant authorities). The Staff examined the basis for that position and concluded that the efficiency costs, if any, at the State level would almost certainly be too low to have relevance for the design of the State income tax. See id.
1. Goal One: Taxation of Income to the Person Who Enjoys Its Benefits

Goal one is that all individuals, married or single, should pay income taxes proportionate with the economic gains that they have enjoyed during the taxable year. A condition necessary for the achievement of that goal is a broad definition of taxable income. The other necessary condition is that income be made taxable to the person who enjoys its economic benefits. The taxation of income to the person who enjoys its benefits is referred to as the "benefit principle."

In a society like the State of New York, where marital partners can be assumed to enjoy approximately equal standards of living,

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14 See McIntyre, supra note 6, at 340.
15 The Staff prepared reports on the tax base in addition to its report on family taxation. The tax base reports reexamined federal concepts of taxable income in the context of the state income tax. In a nutshell, the position of the Staff was that income should be defined, to the extent practicable, according to Haig/Simons principles. See Haig, The Concept of Income—Economic and Legal Aspects, READINGS IN THE ECONOMICS OF TAXATION 59 (R. Musgrave & C. Shoup 1959); H. SIMONS, PERSONAL INCOME TAXATION 50 (1938); see also NEW YORK STATE LEGISLATIVE COMMISSION ON THE MODERNIZATION & SIMPLIFICATION OF TAX ADMINISTRATION & THE TAX LAW, THE NEW YORK STATE PERSONAL INCOME TAX: THE ITEMIZED DEDUCTIONS (Part I) (Staff Report Feb. 18, 1986); NEW YORK STATE LEGISLATIVE COMMISSION ON THE MODERNIZATION & SIMPLIFICATION OF TAX ADMINISTRATION & THE TAX LAW, THE NEW YORK STATE PERSONAL INCOME TAX: PROVISIONS AFFECTING THE DETERMINATION OF GROSS & ADJUSTED GROSS INCOME (Staff Report July 25, 1985); NEW YORK STATE LEGISLATIVE COMMISSION ON THE MODERNIZATION & SIMPLIFICATION OF TAX ADMINISTRATION & THE TAX LAW, THE NEW YORK STATE PERSONAL INCOME TAX: AN OVERVIEW (Staff Report May 29, 1985) [hereinafter OVERVIEW].
16 For discussion of the benefit principle, see McIntyre, supra note 6, at 280-90. That principle was first articulated in McIntyre & Oldman, Taxation of the Family in a Comprehensive and Simplified Income Tax, 90 HARV. L. REV. 1573, 1592-99 (1977).
17 Most tax analysts and most political leaders have been willing to indulge the assumption of marital sharing, despite the surprising lack of empirical evidence on either side of the issue. For a challenge to the assumption of substantial marital sharing, see Dulude, Taxation of the Spouses: A Comparison of Canadian, American, British, French and Swedish Law, 23 OSGOOD HALL L.J. 67, 88-91 (1986). Dulude asserts:

Yes, it appears that couples with very low incomes do share everything because they have no choice. At the other end of the scale the answer is no; spouses who each have substantial incomes and assets do not tend to share much at all. Among middle-income people, sharing seems most common when the spouses are young and have similar incomes and least frequent when the wife has no income and stays home. In fact, with the single exception of the very poor, the earnings and assets of couples are generally controlled and managed by the spouse who has legal title to them.

Id. at 89.

Dulude's challenge to the assumption of substantial marital sharing is strongly stated. It fails, however, for at least two reasons. First, for purposes of the benefit principle, the question to be decided is whether marital partners share the benefits of income. Control over income, which is what Dulude generally is commenting upon, should be relevant only in a tax system that
the benefit principle would require that each marital partner be taxable on his or her presumed share of their aggregate marital income. One technique for implementing the benefit principle is marital income-splitting. The federal government employed that technique from 1948 to 1970.¹⁸

2. Goal Two: Administrative Conformity with Federal Income Tax

Goal two is that the system of family taxation should be simple to administer.¹⁹ The Staff of the Tax Study Commission concluded that the essential requirement for the simplification of administration of the New York personal income tax was the elimination, to the extent feasible, of the need for information sources independent of the Internal Revenue Service (IRS) enforcement machinery. The simplest system would be one that determined a person’s New York tax liability from information already being reported to the IRS. Such reliance on federal information sources imposes some important limitations on state tax policy, but it does not require the state income tax to mirror the policy choices made by the federal government.

makes control over income the measure of taxable capacity. Second, Dulude’s assertions about marital sharing are based largely on her own intuitions and on a misreading of a study by Jan Pahl. See Pahl, Patterns of Money Management Within Marriage, 9 J. Soc. Pol. 313 (1980). Dulude characterizes the study as “the only serious survey—in Great Britain—of the extent of sharing within marriage.” Dulude, supra, at 88. The study summarizes the unsubstantiated reports of some married women interviewed during their stay at Women’s Aid, a center in England for battered women fleeing an untenable home situation. Of the 28 wives in the study who reported on their financial relationship with their husband, 5 claimed to control the family purse and 2 claimed to share control with their husband. Pahl, supra, at 325. The remaining 18 claimed that the husband controlled the money coming into the household. Id. Of that group, 5 claimed they obtained no money at all from the husband and 13 claimed they did receive money. Id. Of those receiving money, 9 claimed the amounts were inadequate for meeting their household obligations and 4 claimed the amounts were adequate. Id. In summary, 80% of the battered wives claimed to be receiving some money from their husband, and 44% were receiving an adequate amount. No inquiry was made about the benefits obtained by the wife from income under the husband’s control. Pahl claims that these findings are relevant for designing welfare programs. Id. at 333-34.

The Pahl study of battered wives, all of whom were considering divorce and were receiving government welfare benefits at the time of the study, does not support Dulude’s contention that sharing among middle- and upper-class marital partners is uncommon. Indeed, the Pahl study provides evidence that some sharing of benefits tends to continue in many marriages even when the normal marital ties of affection and respect have disappeared.


¹⁹See McIntyre, supra note 6, at 314-19, 340.
3. Goal Three: Exemptions for the Poor

Goal three is that individuals who are poor by community standards should be exempt from the New York personal income tax.\textsuperscript{20} New York tax law has always provided for significant low-income relief. Prior to the recent reforms, however, the relief was inadequate, due largely to the effects of inflation on its real value since the amount of the relief was last adjusted in 1975.

The Staff proposed that the low-income relief be liberalized. It recommended that the per capita relief for single and married persons be approximately equal, although the federal poverty level figures—the most widely accepted measure of community standards of poverty\textsuperscript{21}—suggest that the per capita needs of a two-person household are less than the per capita needs of an individual living alone.\textsuperscript{22} The Staff took the position that the poverty figures simply established a floor for adequate low-income relief. Relief measures for individuals above the poverty level figures should be designed to treat all individuals with equal incomes the same, without regard for their choice of living arrangements.

4. Goal Four: Ease of Taxpayer Compliance

Prior to the recent reforms, New York's income tax imposed unreasonable compliance burdens on average taxpayers. Even sophisticated taxpayers engaging in uncomplicated economic transactions required professional assistance in completing their tax returns. The Staff of the Tax Study Commission decided that taxpayers whose incomes were derived chiefly from wages should be able to complete their New York return by themselves once they had completed their federal return.\textsuperscript{23}

5. Goal Five: Illuminate Underlying Policies

The Staff of the Tax Study Commission believed that some of the popular criticisms of federal joint returns were due to a misunder-

\textsuperscript{20} See id. at 321-27, 341.
\textsuperscript{21} See U.S. DEPT. OF COMMERCE, BUREAU OF THE CENSUS, 1980 CENSUS OF POPULATION, CHARACTERISTICS OF THE POPULATION, pt. 1, U.S. Summary, PC80-1-C1. The poverty-level figures set by the government are somewhat arbitrary. They are established to be 3 times the cost of food for a minimum diet, and are adjusted annually for inflation, using the consumer price index. Id. app. B, at B-22.
\textsuperscript{22} Id. app. B, at B-23; see McIntyre, supra note 6, at 341.
\textsuperscript{23} See McIntyre, supra note 6, at 341.
standing of its objectives rather than a rejection of those objectives. It concluded that a system of family taxation, to obtain long-term support from New York taxpayers, should be designed so as to illuminate the policy choices it embodied.\textsuperscript{24}

\textbf{B. Proposals for Reform}

The Staff of the Tax Study Commission made six major recommendations for reform of New York's system of family taxation. Those recommendations are summarized below.

1. Joint Returns with Full Income-Splitting

The Staff proposed that marital partners be made taxable on one-half the aggregate taxable income of their marital partnership.\textsuperscript{25} This proposal was central to its reform package. Two techniques were discussed for taxing married persons: joint filing with income-splitting and a special rate schedule for married couples with tax brackets twice the width of the brackets of the rate schedule applicable to single persons.\textsuperscript{26} Income-splitting was favored over a marital rate schedule because it emphasized the policy goal of equal treatment of all individuals enjoying comparable standards of living.\textsuperscript{27}

2. Unified Low-Income Relief

To exempt the poor from taxation, the Staff recommended that the complex existing system of vanishing credits and deductions be replaced with a per-capita exemption.\textsuperscript{28} The personal exemptions for the taxpayer and spouse, the household credit, the low-income exemptions, and the minimum standard deduction of existing law would be repealed.\textsuperscript{29} The new per-capita exemption, which would function as a zero tax bracket, would provide substantially more relief for the poor than the relief mechanisms it would replace.

\textsuperscript{24} Id. at 342.
\textsuperscript{25} Id.
\textsuperscript{26} Id. at 282-86.
\textsuperscript{27} Id. at 285.
\textsuperscript{28} Id. at 342-46.
\textsuperscript{29} Id. at 342
3. Rate Simplification

To prevent the expanded low-income relief from providing unwarranted benefits to middle- and upper-income taxpayers, the Staff of the Tax Study Commission proposed the elimination of the lowest two tax brackets (2% and 3%). In effect, the expanded zero bracket would replace the 2% bracket and the 3% bracket. The income previously taxed at those low rates would be exempt from tax because of the zero bracket. The first dollar of income above the zero bracket would be subject to tax at the rate of the third bracket (4%).

The Staff’s report on family taxation did not discuss more fundamental changes in the rates. The Staff was on record, however, as favoring an expansion of the tax base and a lowering of the marginal tax rates.

4. Expanded Dependency Deductions

At the time the report of the Staff was being prepared, New York was providing a per capita exemption of $800 for the taxpayer and qualifying dependents. The Staff proposed that the dependency exemptions be decoupled from the taxpayer exemptions. That is, the amount of the dependency exemptions and the amount of the taxpayer exemptions would be determined independently. It also recommended an increase in the dependency deduction to $1,500 for the first dependent and to $1,000 for subsequent dependents. An important function of the $1,500 exemption for the first dependent was to give proper tax relief to heads of households of modest means.

5. Repeal of the Child-Care Credit

Like the federal government, New York provided a child-care credit for qualifying parents. The credit had some unattractive

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30 Id. at 345.
31 Id.
32 See OVERVIEW, supra note 15, at 2 (endorseing the trade-off of less deductions for lower rates proposed by the Treasury Department).
33 See McIntyre, supra note 6, at 346-47.
34 Id. at 331.
35 Id. at 346-47.
36 Id.
aspects. For example, taxpayers with qualifying dependents could claim a credit even if they were paying for maid service instead of child care.\textsuperscript{30} The Staff proposed that New York "should consider repealing the child-care credit."\textsuperscript{40} It believed that the credit had some merit but that all of the arguments made in support of it had weaknesses.\textsuperscript{41} The Staff was not willing to endorse repeal of the credit unless expanded relief for heads of households, in the form of larger dependency exemptions and an expanded low-income allowance, was a part of the reform package.\textsuperscript{42}

6. Repeal of Higher Education Deductions

New York provided a deduction for certain tuition payments and for certain contributions to qualified higher education trust funds.\textsuperscript{43} The program of higher education deductions was referred to as the PASS program (Parents And Students’ Savings). The Staff of the Tax Study Commission argued that the PASS program was an inefficient tax expenditure program that should be repealed.\textsuperscript{44}

II. THE RESULTS OF THE 1985 AND 1987 TAX CHANGES

The 1985 Tax Act\textsuperscript{45} was initially conceived of as a tax reduction bill that would not make fundamental changes in the New York

\textsuperscript{30} N.Y. Tax Law § 606(c)(1) (McKinney 1987) (New York child-care credit amount determined as a percentage of the federal child-care credit allowed under Internal Revenue Code, I.R.C. § 21(b)(2)(A)(i) (Supp. II 1984) (defining employment-related expenses to include "expenses for household services").

\textsuperscript{40} McIntyre, supra note 6, at 347.

\textsuperscript{41} Id.

\textsuperscript{42} Id.


\textsuperscript{44} McIntyre, supra note 6, at 347.

\textsuperscript{45} Act of Apr. 8, 1985, ch. 29, 1985 N.Y. Laws 50.
personal income tax system. Some important family-related changes were made, nevertheless, in the 1985 Tax Act. Those changes are discussed below in section A.

The Tax Reform and Reduction Act of 1987 (TRRA of 1987), in contrast, was designed from the start as major reform legislation. The scope of the reform was substantially expanded, however, as the bill moved through the legislative process. The family-related changes made by the TRRA of 1987 and its companion legislation are addressed in section B.

Table 1, below, shows the distributional impact of the 1985 and 1987 reforms on some representative taxpayers. Those taxpayers are assumed to be taking a standard deduction and to have only earned income. As the table indicates, married couples and heads of households received comparatively more tax relief than single persons. For many high income individuals, the tax relief obtained from the rate reductions would be offset, in whole or in part, by the elimination of the capital gains preference and the restrictions on itemized deductions.

A. The 1985 Changes

The Governor's proposals for tax reform made in early 1985 provided for substantial tax reductions, including provisions for expanded low-income relief. The low-income relief proposed for heads of households was particularly noteworthy. No basic reforms of the existing tax structure were supported.

The Senate, controlled by the Republicans, favored substantially larger tax reductions than those proposed by the Governor. The Assembly, controlled by the Democrats, favored some expansion of

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46 The reform agenda was initially set by the Governor's proposed Budget Bill. N.Y.S. 2540, N.Y.A. 3340, 208th Sess. (1985); see infra note 47.
47 See infra notes 51-65 and accompanying text.
49 See infra notes 66-118 and accompanying text.
50 See infra notes 66-111 and accompanying text.
52 Id. § 15(2)(D) (proposed amendment to N.Y. TAX LAW § 606(b) (McKinney 1985)).
Table 1
REDUCTIONS IN 1984 TAX BURDENS (IN Dollars AND PERCENTAGES)
RESULTING FROM THE 1985 AND 1987 TAX REFORMS,
BY TYPE OF HOUSEHOLD AND GROSS INCOME LEVEL

<table>
<thead>
<tr>
<th>Gross Income Level</th>
<th>$10,000</th>
<th>$20,000</th>
<th>$30,000</th>
<th>$40,000</th>
<th>$60,000</th>
<th>$120,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of Household</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>'85 Act</td>
<td>'87 Act</td>
<td>'85 Act</td>
<td>'87 Act</td>
<td>'85 Act</td>
<td>'87 Act</td>
</tr>
<tr>
<td>Single (no children)</td>
<td>70(28)</td>
<td>112(45)</td>
<td>68(7)</td>
<td>302(30)</td>
<td>164(8)</td>
<td>643(32)</td>
</tr>
<tr>
<td>Head of Household</td>
<td>129(68)</td>
<td>190(100)</td>
<td>189(21)</td>
<td>442(49)</td>
<td>280(14)</td>
<td>933(48)</td>
</tr>
<tr>
<td>(one child)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Husband &amp; Wife</td>
<td>153(80)</td>
<td>190(100)</td>
<td>417(46)</td>
<td>525(58)</td>
<td>370(29)</td>
<td>1016(52)</td>
</tr>
<tr>
<td>100/0 split</td>
<td>75/25 split</td>
<td>149(100)</td>
<td>195(29)</td>
<td>279(42)</td>
<td>319(21)</td>
<td>591(39)</td>
</tr>
<tr>
<td>50/50 split</td>
<td>99(73)</td>
<td>136(100)</td>
<td>125(21)</td>
<td>209(35)</td>
<td>146(11)</td>
<td>418(31)</td>
</tr>
<tr>
<td>Husband, Wife,</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>&amp; Two Children</td>
<td>112(100)</td>
<td>112(100)</td>
<td>406(54)</td>
<td>482(64)</td>
<td>582(32)</td>
<td>956(53)</td>
</tr>
<tr>
<td>100/0 split</td>
<td>75/25 split</td>
<td>85(100)</td>
<td>200(37)</td>
<td>270(50)</td>
<td>313(23)</td>
<td>541(40)</td>
</tr>
<tr>
<td>50/50 split</td>
<td>84(100)</td>
<td>84(100)</td>
<td>153(31)</td>
<td>223(45)</td>
<td>172(14)</td>
<td>776(36)</td>
</tr>
</tbody>
</table>

Source: Computed from provisions of New York Tax Law by Brien R. Downes, Counsel to the Tax Study Commission. All taxpayers are assumed to be earning only earned income and to be taking a standard deduction. The 1985 and 1987 Tax Acts are assumed to be fully in effect.
the Governor’s proposed tax reductions.\textsuperscript{55} Relying on the work of the Tax Study Commission Staff, the Assembly also favored some reform of the existing tax structure, including a simplification of the low-income relief mechanisms.\textsuperscript{56}

The compromise legislation finally enacted made two important changes in the tax treatment of the family. First, the low-income relief was greatly expanded and was aimed at families, particularly single parent families. In form, the complex set of mechanisms for delivering low-income relief were preserved. In practice, however, the new system was more simple than the old because of a general exemption from taxation for single persons with incomes below $4,000 and for married couples and heads of households with incomes below $8,000.\textsuperscript{57} The effect of those exemptions was to render moot the complex phase-out provisions of the household credit.\textsuperscript{58} The tax-free amounts before and after the 1985 and 1987 tax acts are presented in Table 2.

The second change introduced by the 1985 Tax Act was the so-called family adjustment.\textsuperscript{59} The family adjustment reduced the tax

\begin{table}[h]
\begin{center}
\begin{tabular}{lccc|ccc|ccc}
\hline
Type of Household & \multicolumn{3}{c}{Number of Dependents} & \multicolumn{3}{c}{Number of Dependents} & \multicolumn{3}{c}{Number of Dependents} \\
\hline
Married Couple & 5,767 & 8,433 & 13,000 & 6,230 & 9,333 & 14,000 & 7,000 & 10,233 & 15,000 \\
Heads of Household & N/A & N/A & N/A & 5,767 & 8,433 & 11,500 & 6,230 & 9,333 & 12,500 \\
Unmarried Individual (without dependents) & 4,967 & 6,033 & 7,500 & N/A & N/A & N/A & N/A & N/A & N/A \\
\hline
\end{tabular}
\end{center}
\caption{TOTAL TAX-FREE AMOUNTS OF TYPE OF HOUSEHOLD AND NUMBER OF DEPENDENTS: BEFORE 1985, AFTER THE 1985 TAX ACT*, AND AFTER THE TRRA OF 1987*}
\end{table}

\* The tax-free amounts are determined without reference to transition rules. The 1985 Tax Act never became fully effective because of the adoption of the TRRA of 1987. The tax-free amounts under the 1985 Act are for the year 1987. The tax-free amounts under the TRRA of 1987 are for the year 1991.


\textsuperscript{55} See generally Lowe & Santoro, Budget snafu to end, Leg. Gazette, Apr. 1, 1985, at 1, col. 3.

\textsuperscript{56} For description of the low-income relief mechanisms under pre-1985 law, see McIntyre, \textit{supra} note 6, at 302-04.

\textsuperscript{57} Act of Apr. 8, 1985, ch. 29, § 17, 1985 N.Y. Laws 50, 56 (amending N.Y. TAX LAW § 601(a)(2)).

\textsuperscript{58} The 1985 Tax Act added to the complexity of the household credit. See Act of Apr. 8, 1985, ch. 29, § 22, 1985 N.Y. Laws 50, 59-60, \textit{repealed by TRRA of 1987}, \textit{supra} note 2, § 12, at 77-78 (repealing N.Y. TAX LAW § 606(b)(1), (2)).

differential among equal income married couples resulting from New
York's separate filing rule. It allowed marital partners filing separately
to shift up to $5,000 from the income of the spouse with the higher
income to the spouse with the lower income.\footnote{Id. The 1985 Tax Act provided for a shift of up to $5,000 for 1987 and thereafter. \textit{Id.} (former N.Y. TAX LAW § 616-A(a), (b)(1)). For 1985, the maximum shift was $3,000, and for 1986, it was $4,000. \textit{Id.}}

Married couples filing jointly also obtained a benefit from the family
allowance. These couples would first compute their taxable income
excluding the $5,000. They would then compute the tax that would
have been payable on the $5,000 if it had been their only income.
The sum of the two amounts would be the tax liability of the couple.\footnote{Id. (former N.Y. TAX LAW § 616-A(a), (b)(2)).}

To limit the revenue loss from adoption of the family adjustment
and to direct the limited tax relief at moderate-income couples, the
family adjustment was phased out for couples with gross incomes
over $31,000. For married couples with income in excess of $31,000,
the maximum amount of the family adjustment was $5,000 minus
$500 for every $1,000 (or portion thereof) of marital income over
$31,000.\footnote{Id. (former N.Y. TAX LAW § 616-A(c)). For 1987 and thereafter, couples with adjusted
gross income over $40,000 were not eligible for the family adjustment because of the phase-out
rule. For 1986, the phase-out was complete at $39,000, and in 1985 it was complete at $36,000. \textit{Id.}}

In principle, the family adjustment was quite simple. Consider, for
example, two marital partners, H and W. H has taxable income of
$20,000, computed without regard to the family adjustment, and W
has taxable income of $6,000. H and W would elect to take the family
adjustment of $5,000. Thus H would be taxable on $15,000, and W
would be taxable on $11,000. Because of the effects of progressive
tax rates, the shift of income to the lower-income spouse would result
in a net tax savings for the married couple.\footnote{Without the family adjustment, the couple's combined tax would be $1485; with a family
adjustment of $4,500 (reduced from the maximum $5,000 because their household income is
$31,600) their combined tax is $1,355—a savings of $130.}

The family adjustment was successful in curtailing the implicit tax
penalty on married couples with uneven income splits, as shown in
Table 3. It was, however, somewhat complicated in practice. The
complications were due in large measure to the way that it interacted
with the maximum tax on earned income. The New York State
Department of Taxation & Finance (Tax Department) estimated that
31 percent of married couples made a mistake on their tax returns
in 1986 because of difficulties with the family adjustment.\textsuperscript{64} Despite the administrative problems it created, the family adjustment represented a major step toward reform of the New York system of family taxation. It provided for limited income-splitting between marital partners—the solution to the flaws in the existing tax structure recommended by the Staff of the Tax Study Commission.\textsuperscript{65} For the first time, the New York Legislature had recognized the unfairness of requiring married couples with equal incomes to pay substantially unequal taxes. The revenue lost by adopting the family adjustment, moreover, gave relief to those taxpayers who would have benefited from income-splitting. Thus, the potential revenue loss from a change to income-splitting was reduced significantly. In short, the family adjustment had made a substantial down-payment on more comprehensive reform.

\section*{B. The 1987 Changes}

The Tax Reform and Reduction Act of 1987 (TRRA of 1987)\textsuperscript{66} is landmark legislation, comparable in scope to the federal Tax Reform

\begin{table}[h]
\centering
\caption{INCOME SOURCE PENALTIES IMPOSED UNDER THE 1985 TAX ACT ON MARITAL PARTNERS HAVING UNEQUAL SEPARATE INCOMES, WITHOUT AND WITH THE FAMILY ADJUSTMENT (FA)}
\begin{tabular}{lcccc}
\hline
\textbf{Adjusted Gross Income} & \textbf{One-Income Couples} & \textbf{75/25 Split Couples} \\
\hline
\textbf{Income} & \textbf{w/o FA} & \textbf{with FA} & \textbf{w/o FA} & \textbf{with FA} \\
\hline
10,000 & 24 & 0 & 0 & 0 \\
20,000 & 252 & 24 & 51 & 0 \\
30,000 & 464 & 174 & 110 & 0 \\
40,000 & 500 & 465 & 68 & 58 \\
60,000 & 500 & 500 & 0 & 0 \\
120,000 & 500 & 500 & 0 & 0 \\
\hline
\end{tabular}
\end{table}

Source: Computed by Brian R. Downes, Counsel to the Tax Study Commission, from provisions of New York Tax Law, as amended by 1985 Tax Act, for 1987. All taxpayers assumed to be taking a standard deduction.

\textsuperscript{64} See Memorandum from Leonard Finke to Steve Zych, Family Adjustment Statistics, N.Y.S. Dept. Tax & Finance (Oct. 15, 1986). According to that memorandum, only 20\% of returns processed were entitled to the family adjustment. \textit{Id.} Of the 31\% making errors, 55\% made errors that reduced declared tax and 45\% made errors that increased declared tax. \textit{Id.} at 2. The tax department recomputed each taxpayer’s family adjustment to ensure that he or she received a correctly computed family adjustment benefit. \textit{Id.} at 1.

\textsuperscript{65} See McIntyre, \textit{supra} note 6, at 342.

Act of 1986.\textsuperscript{67} What the TRRA of 1987 did not do is as important as what it did do. Under New York law, the definition of New York taxable income is based upon the federal definition of adjusted gross income.\textsuperscript{68} The loopholes and special tax preferences eliminated at the federal level by the 1986 reforms, therefore, were eliminated at the State level as well. The Legislature resisted the temptation to reinstitute the New York loopholes and preferences that had been eliminated by the federal Tax Reform Act of 1986.\textsuperscript{69}

Building upon the federal reforms, the TRRA of 1987 made significant changes of its own in New York's tax law. Three major changes made in New York's system of family taxation were particularly important. Those changes are described in subsections 1, 2, and 3, below. Two additional minor changes are discussed in subsection 4. All of these changes are compatible with the goals that the Staff of the Tax Study Commission had established for the design of an ideal system of family taxation.

1. Mandatory Joint Filing

The first of the major changes in family taxation was the introduction of mandatory joint filing. The Staff of the Tax Study Commission had advocated joint filing in 1985 without finding any takers in the legislature or the Governor's office. By 1987, joint filing appeared on the reform agenda of the Assembly, the Senate, and the Governor's office. The adoption of the family allowance in 1985 appears to have made joint filing an attractive political option. Joint filing was promoted by the Staff as a mechanism not only for eliminating the taxpayer compliance and administrative difficulties of the family adjustment but also for providing a more complete solution to the fairness problems that the family adjustment was designed to address.

The 1987 reform legislation was shaped by proposals made by the

\textsuperscript{67} Pub. L. No. 99-514, 100 Stat. 2085.
\textsuperscript{68} N.Y. TAX LAW § 611(a) (McKinney 1987) (defining New York taxable income); id. § 612(a) (defining New York adjusted gross income in terms of federal adjusted gross income).
\textsuperscript{69} Pub. L. No. 99-514, 100 Stat. 2085. In its preliminary work on reform of the tax base, the Staff had proposed broad-based reforms similar to those enacted at the federal level. See NEW YORK STATE LEGISLATIVE COMMISSION ON THE MODERNIZATION & SIMPLIFICATION OF TAX ADMINISTRATION & THE TAX LAW, THE NEW YORK STATE PERSONAL INCOME TAX: THE ITEMIZED DEDUCTIONS (Part I) (Staff Report Feb. 18, 1986); NEW YORK STATE LEGISLATIVE COMMISSION ON THE MODERNIZATION & SIMPLIFICATION OF TAX ADMINISTRATION & THE TAX LAW, THE NEW YORK STATE PERSONAL INCOME TAX: PROVISIONS AFFECTING THE DETERMINATION OF GROSS & ADJUSTED GROSS INCOME (Staff Report July 25, 1985); OVERVIEW, supra note 15.
Governor, the Senate, and the Assembly. The first formal proposal for reform was made by the Senate. The Senate plan, most taxpayers would have reported income on what was called the postcard option. The postcard option would have imposed a flat-rate tax of 5.5 percent on New York taxable income, defined, with some modifications, in terms of federal adjusted gross income. Married taxpayers were required under that option to file joint returns. Because of the flat rate, the joint filing requirement had no distributional significance.

As an alternative, the Senate plan would have allowed taxpayers to elect to pay tax on what was called the regular tax option. Although the regular tax option lowered taxes and made some structural reforms, it largely retained the features of the existing law, including the separate filing rule.

Governor Mario Cuomo made three separate proposals, referred to as Governor I, Governor II, and Governor III. Governor I was issued in December of 1986, and Governor II and III were issued in February of 1987. All three proposals called for the introduction of mandatory joint filing. In adopting that position, the Governor was following the recommendation of the Council on Fiscal and Economic Priorities, which the Governor had established in 1983 and had asked to formulate reform proposals.

A special rate schedule for married couples was provided in all

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70 The Senate plan was first introduced on December 12, 1986, during the 1986 Special Session, as S. 9693. On January 7, 1987, it was reintroduced as S. 1 of the 1987-1988 Regular Sessions.
72 Id. §§ 41, 90.
73 Id. § 45.
74 Governor's Memorandum (Bill Draft, 209th Sess., Dec. 17, 1986) [hereinafter Governor I] (available at the offices of the Tax Study Commission, Albany, N.Y.). Governor I was never formally introduced as a bill and thus has no bill number.
75 N.Y.S. 2530, N.Y.A. 3430, 210th Sess. (1987) [hereinafter Governor II]. Governor II was introduced on February 20, 1987. It was designed to reduce New York taxes by the amount of the so-called federal windfall—that is, by the amount of the increase in State revenues resulting from the federal reforms of 1986.
76 Governor's Memorandum (Program Bill Draft 1987, 210th Sess.) [hereinafter Governor III] (available at the offices of the Tax Study Commission, Albany, N.Y.). Governor III was circulated in February of 1987 but was never introduced as a bill. It provided for a tax cut in addition to a return of the federal windfall.
77 See CHANGES IN NEW YORK STATE TAXES: THE CHALLENGE OF FEDERAL TAX REFORM, A REPORT FROM THE COUNCIL ON FISCAL AND ECONOMIC PRIORITIES 10, 11 (Dec. 1986). No arguments were advanced in support of that recommendation, nor were the details of the recommendation spelled out. The Council members had consulted extensively with the Staff of the Tax Study Commission. The Staff of the Commission had prepared a memorandum for Council members, one of the subjects of which was the benefits of a joint filing rule. The Staff had also met at some length with Perry Quick, a consultant to James D. Robinson III, Co-Chairman of the Committee on Tax Policy and Economic Development of the Council.
three of the Governor's plans. The separate rate schedules for single and married taxpayers were designed to achieve the equivalent of 60/40 income-splitting at most income levels.\textsuperscript{78} To reduce the marriage penalty on equal-income couples resulting from those rate schedules, a two-earner deduction equal to 10\% of the income of the lower-earner spouse, capped at $50,000, was proposed.\textsuperscript{79}

The Assembly introduced its reform plan, the Fair and Simple Tax Act of 1987 (FAST Plan),\textsuperscript{80} on January 7, 1987. Proposed by Assembly Speaker Miller and Ways and Means Chairman Weprin, it would have expanded the tax base, provided a generous zero bracket, and imposed a tax on amounts in excess of the zero bracket at 6.75\%.\textsuperscript{81} It also would have required married couples filing joint federal returns to file jointly at the State level as well.\textsuperscript{82} The FAST plan was easily the most radical of the reform plans placed on the legislative agenda in 1987.

Under the reforms actually included in the TRRA of 1987, marital partners residing in New York who file a federal joint return must file a New York joint return\textsuperscript{83} and must pay tax on a special marital rate schedule.\textsuperscript{84} In almost all situations, married couples would obtain a tax benefit from filing a joint return. When the reform legislation is fully effective in 1991, a husband and wife will pay tax on their aggregate income at the rates set forth in Table 4, below. Those rates are very close to the rates that would be applicable in a tax system that provided for full income-splitting between marital partners.\textsuperscript{85}

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\textsuperscript{78} The tax tables generally were constructed to achieve a 60/40 marital income split, but they varied from that goal in certain brackets.

\textsuperscript{79} See Governor I, supra note 74, at 97.

\textsuperscript{80} N.Y.A. I, 210th Sess. (1987) [hereinafter FAST Plan].

\textsuperscript{81} See Press Release Assembly Democratic Leaders Unveil Single-Rate Tax Reform Plan (Feb. 26, 1987) (issued by Assembly Speaker Mel Miller and Assembly Ways and Means Committee Chairman Saul Weprin).

\textsuperscript{82} FAST Plan, supra note 80, \$ 155.

\textsuperscript{83} TRRA of 1987, supra note 2, \$ 29(b)(2), 1987 N.Y. Laws at 94 (imposing joint filing requirement) (amending N.Y. TAX LAW \$ 611(b)(2)).

\textsuperscript{84} Id. \$ 3, 1987 N.Y. Laws at 68 (marital rate schedule) (amending N.Y. TAX LAW \$ 601(a)(1)).

\textsuperscript{85} A marital rate schedule, to be functionally equivalent to an income-splitting system, must have the same rates as the individual rate schedule and brackets twice as wide. For example, if the New York rate schedule applicable to single persons is left unchanged, the following marital schedule would produce the same distribution of burdens as a marital income-splitting rule:

<table>
<thead>
<tr>
<th>Rate</th>
<th>Taxable Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>$0 to $15,000</td>
</tr>
<tr>
<td>5.5%</td>
<td>$15,000 to $40,000</td>
</tr>
<tr>
<td>7.0%</td>
<td>over $40,000</td>
</tr>
</tbody>
</table>

This schedule is very similar, in its distributional impact, to the actual New York rate
large measure, therefore, the central recommendation of the Staff for full marital income-splitting has been adopted by the Legislature.

2. Expanded Low-Income Relief

The second major change made by the TRRA of 1987 in New York's system of family taxation was a further expansion of low-income relief and a simplification of the mechanism for delivering that relief. Single persons were given a per capita standard deduction, beginning in 1990, of $7,500.\footnote{TRRA of 1987, supra note 2, § 64, 1987 N.Y. Laws at 100-02 (amending N.Y. TAX LAW 614(a)).} The standard deduction in 1991 for married couples will be $13,000, amounting to a per capita deduction of $6,500.\footnote{Id. (amending N.Y. TAX LAW § 614(b), (d)).} Heads of households will be granted a standard deduction of $10,500.\footnote{Id. (amending N.Y. TAX LAW § 614(c)).} Because of these standard deductions, the low-income relief under the New York tax law generally will be more generous than the relief granted under the federal tax code.\footnote{The federal Tax Reform Act of 1986 provides, as of 1989, effective zero brackets as follows: (1) single persons with no dependents: $5,000 ($3,000 standard deduction + $2,000 personal exemption); (2) husband and wife with no dependents: $9,000 ($5,000 standard deduction + $4,000 personal exemption); and (3) head of household with one dependent: $8,400 ($4,400 personal exemption).}

<table>
<thead>
<tr>
<th>Table 4</th>
<th>STATUTORY RATE SCHEDULES, 1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax rates (%)</td>
<td>Taxable Income ($)</td>
</tr>
<tr>
<td>5.5</td>
<td>0 to 27,000</td>
</tr>
<tr>
<td>7</td>
<td>Over 27,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Table 5</th>
<th>RATE SCHEDULES INCORPORATING STANDARD DEDUCTION, 1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax rates (%)</td>
<td>Taxable Income ($)</td>
</tr>
<tr>
<td>0</td>
<td>0 to 13,000</td>
</tr>
<tr>
<td>5.5</td>
<td>13,000 to 40,000</td>
</tr>
<tr>
<td>7</td>
<td>Over 40,000</td>
</tr>
</tbody>
</table>
As part of the expansion of the standard deduction, the old mechanisms for delivering low-income relief, other than the dependency exemption, were repealed. In effect, the household credit, the taxpayer exemptions, the low-income exemptions, and the old minimum standard deduction were all folded into the new standard deduction. This reform is almost precisely the change in low-income relief recommended by the Staff of the Tax Study Commission.

The standard deduction functions as a zero tax bracket for taxpayers who do not itemize. Table 5, above, shows the 1991 rate schedules with the standard deductions treated as amounts taxable at a zero rate. Folding the low-income relief into the rate schedules clarifies that the post-1990 system of family taxation in New York is very close to a full income-splitting system.

There are two important consequences of the new standard deduction unrelated to its function in providing low-income relief. First, because it is an alternative to itemized deductions, it reduces the value of itemized deductions for all New York taxpayers. For the majority of taxpayers electing to claim the standard deduction, it reduces the value of those deductions to zero.

In addition, because the personal exemption for the taxpayer and spouse have been folded into the standard deduction, those taxpayer exemptions are now uncoupled from the dependency exemptions. Thus, contrary to prior law, an increase in the dependency exemption no longer would result in an equal increase in the taxpayer exemptions. The Staff had recommended decoupling because of the different functions that those exemptions serve in an ideal income tax system. It noted that “only by happenstance would the appropriate level for

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standard deduction + $4,000 personal exemption). Pub. L. No. 99-514, § 102, 100 Stat. 2085, 2099-102 (increase in standard deduction); id. § 103, at 2102-03 (increase in personal exemptions). The amounts are to be indexed for inflation. Tax Reform Act of 1986, Pub. L. No. 99-514, § 103, 100 Stat. 2085, 2102, 2103. Even adjusted for inflation, these amounts are substantially less than the zero-bracket amounts provided under New York law. For taxpayers with very large families, however, the federal relief would exceed the New York relief. See infra Table 6. The federal government also provides some relief to households with very low incomes through the refundable earned income credit. I.R.C. § 32 (1982 & Supp. III 1985 & West Supp. 1987). The credit has been designed largely to rebate the Social Security tax. Id.

E.g., TRRA of 1987, supra note 2, § 12 1987 N.Y. Laws at 100-02 (household credit allowed for the taxable year beginning in 1990 reduced by 50%) (amending N.Y. TAX LAW § 606(b)(1),(2)); id. § 68 (denying N.Y. personal exemption to taxpayer whose federal exemption amount is zero) (amending N.Y. TAX LAW § 616).

TRRA of 1987, supra note 2, § 64 (amending N.Y. TAX LAW § 614).

See McIntyre, supra note 6, at 342-46.

The dependency exemptions are provided by N.Y. TAX LAW § 616, which incorporates the federal definition of dependents contained in I.R.C. § 151(c) (1982).

See McIntyre, supra note 6, at 343-44.
the dependency exemption be the same as the appropriate level for the personal exemption.\textsuperscript{95}

An expansion of low-income relief enjoyed widespread political support in New York. It had been a major recommendation of the Council on Fiscal and Economic Priorities\textsuperscript{96} and had been accepted by the Governor.\textsuperscript{97} The Senate bill would have also enriched the low-income allowance,\textsuperscript{98} the personal and dependent exemptions,\textsuperscript{99} and the standard deduction.\textsuperscript{100} The Assembly, in its FAST Plan, would have provided expanded low-income relief by rolling the various low-income relief mechanisms, other than the dependency exemption, into a large standard deduction.\textsuperscript{101} The actual reform legislation adopted the FAST position.\textsuperscript{102}

3. Heads-of-Households Rate Schedule

The third major change in family taxation made by the TRRA of 1987 was the introduction of the special rate schedule for heads of households.\textsuperscript{103} The effect of that rate schedule is to provide for limited income-splitting within families headed by a single parent.

Neither the Governor nor the Senate, in their reform plans, provided for special tax benefits for heads of households. Nor was the treatment of heads of households addressed in the Report of the Council on Fiscal and Economic Priorities. The issue of how to treat heads of households was placed on the legislative agenda by the FAST plan.\textsuperscript{104} Under that plan, heads of households would have received a standard deduction of $12,000, which was the midpoint between the standard deduction of $8,000 proposed for single persons and the $16,000 standard deduction proposed for married couples.\textsuperscript{105} In the FAST plan,

\textsuperscript{95} Id.
\textsuperscript{96} See supra note 77.
\textsuperscript{97} See Governor II, supra note 75, §61 (low income allowance); id. § 70 (household credit); id. § 74 (real property tax circuit breaker credit); see also Governor III, supra note 76, § 2 (increasing the household credit and indexing the credit for inflation after 1982); id. § 3 (increasing the personal exemption).
\textsuperscript{98} N.Y.S. 1, § 40, 210th Sess. (1987).
\textsuperscript{99} Id. § 80.
\textsuperscript{100} Id. § 79.
\textsuperscript{101} FAST Plan, supra note 80, § 142.
\textsuperscript{102} TRRA of 1987, supra note 2, § 64, 1987 N.Y. Laws at 100-02 (amending N.Y. Tax Law § 614).
\textsuperscript{103} Id. § 3, 1987 N.Y. Laws at 68-73 (amending N.Y. Tax Law § 601(b)).
\textsuperscript{104} See New York State Assembly Memorandum in Support of Legislation (the FAST Plan, supra note 80), at 4.
\textsuperscript{105} FAST Plan, supra note 80, § 142.
the standard deduction operated as a zero-bracket. Thus it was functionally equivalent to a special rate schedule for heads of households. The recommendation for a special heads-of-households schedule emerged from the negotiations between the Senate and the Assembly. It was recommended as a mechanism that would preserve for middle-income taxpayers the benefits of the zero-bracket provided by the FAST plan.

The Staff of the Tax Study Commission had recommended against the adoption of a head-of-household schedule.\textsuperscript{106} Under the "benefit principle,"\textsuperscript{107} income-splitting among family members is proper, whether achieved through some splitting formula or through a family rate schedule.\textsuperscript{108} A prerequisite for splitting, however, is aggregation of the income of the members of the family.\textsuperscript{109} Because the federal government does not require aggregation of family income, a state requirement of aggregation was considered by the Staff to be unworkable.\textsuperscript{110}

The heads-of-households schedule adopted in New York, however, does not represent a serious departure from the Staff's recommendations. Like the reformed federal heads-of-households schedule, it provides most of its benefits, as a percentage of income, to low-income families.\textsuperscript{111} It is reasonable to assume that in most low-income

\textsuperscript{106} See McIntyre, supra note 6, at 332-33.
\textsuperscript{107} See supra note 16 and accompanying text.
\textsuperscript{108} See McIntyre, supra note 6, at 332-33.
\textsuperscript{109} Id.
\textsuperscript{110} Id.
\textsuperscript{111} The federal heads-of-households schedule, prior to the 1986 reforms, provided very substantial benefits to high-income families. See McIntyre & Oldman, supra note 16, at 1630 (app. V). That is not true of the 1987 New York legislation. The table below shows the deduction equivalent amount for New York taxpayers at representative income levels. The deduction equivalent is the amount of the deduction that a head of household using the individual rate schedule would need to obtain the same tax relief as is provided by the head of household rate schedule.

\begin{tabular}{|c|c|c|}
\hline
Taxable Income & Deduction Equivalent Amount & Percent of Income \\
$12,500 & 0 & 0 \\
$13,500 & $15 & 0.11% \\
$14,500 & $30 & 0.21% \\
$15,500 & $45 & 0.29% \\
$16,500 & $60 & 0.36% \\
$17,500 & $75 & 0.43% \\
$18,500 & $90 & 0.49% \\
$19,500 & $105 & 0.54% \\
$20,500 & $105 & 0.51% \\
$30,000 & $105 & 0.35% \\
$40,000 & $105 & 0.26% \\
$50,000 & $105 & 0.21% \\
\hline
\end{tabular}
families, the qualified dependents would not have substantial separate incomes. Thus, the lack of an aggregation requirement may have very modest policy significance.

4. Other Changes

The TRRA of 1987 made two other changes in New York's system of family taxation. It repealed the Parent and Student Savings (PASS) Program,\textsuperscript{112} which the Staff characterized as an inefficient tax expenditure.\textsuperscript{113} That change was useful, although it was not a significant structural change. Of the reform plans on the legislative agenda, only the FAST plan would have repealed that program.\textsuperscript{114}

The tax credit for child care was also repealed by the TRRA of 1987.\textsuperscript{115} That change would be important except for the fact that the child-care credit was reinstated as part of the corporate tax reform bill passed in July of 1987.\textsuperscript{116} The Staff of the Tax Study Commission had suggested that the child-care credit might be repealed, but it had made no firm recommendation.\textsuperscript{117} The FAST plan would also have repealed the child-care credit.\textsuperscript{118}

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Deduction Equivalent Amount</th>
<th>Percent of Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>$60,000</td>
<td>$105</td>
<td>0.18%</td>
</tr>
<tr>
<td>$70,000</td>
<td>$105</td>
<td>0.15%</td>
</tr>
<tr>
<td>$80,000</td>
<td>$105</td>
<td>0.13%</td>
</tr>
<tr>
<td>$90,000</td>
<td>$105</td>
<td>0.12%</td>
</tr>
<tr>
<td>$100,000</td>
<td>$105</td>
<td>0.11%</td>
</tr>
<tr>
<td>$200,000</td>
<td>$105</td>
<td>0.05%</td>
</tr>
<tr>
<td>$300,000</td>
<td>$105</td>
<td>0.04%</td>
</tr>
<tr>
<td>$400,000</td>
<td>$105</td>
<td>0.03%</td>
</tr>
<tr>
<td>$500,000</td>
<td>$105</td>
<td>0.02%</td>
</tr>
</tbody>
</table>


\textsuperscript{112} See supra note 43 (setting forth the legislative history of the PASS program).
\textsuperscript{113} See McIntyre, supra note 6, at 335-37.
\textsuperscript{114} FAST Plan, supra note 80, § 118.
\textsuperscript{115} TRRA of 1987, supra note 2, § 14, 1987 N.Y. Laws at 79 (adding a sunset provision for the child-care credit, effective in 1989).
\textsuperscript{116} Business Tax Reform and Rate Reduction Act of 1987, ch. 817, § 57-m, 1987 N.Y. Laws 3094, 3123 (codified at N.Y. TAX LAW § 606(c) (McKinney 1987)) (repealing the 1989 sunset provision, see supra note 115).
\textsuperscript{117} See supra note 44 and accompanying text.
\textsuperscript{118} See FAST Plan, supra note 80, § 109.
III. DIRECTIONS FOR FUTURE REFORM

New York's system of family taxation is based upon a coherent concept of horizontal equity. By removing source distinctions contained in prior law, the Legislature has endorsed the view that individuals who enjoy the benefits of equal amounts of income should pay equal taxes. The old distinction between earned and unearned income is gone, as is the distinction between capital gains and ordinary income. And with the adoption of a joint filing rule, it no longer matters whether an individual's standard of living is financed by his or her own earnings or from the earnings of a spouse.

Three changes in current law would be appropriate to consolidate the recent reforms. Section A discusses a proposal for indexing the standard deduction for inflation. A proposal for more extensive tax relief for taxpayers with dependents is discussed in Section B. The modest changes in current law necessary to provide for full income-splittting are discussed in Section C.

A. Indexing the New Standard Deduction

The standard deduction should be indexed for inflation, using the same inflation index employed by the federal government in adjusting its standard deduction. In times of budget surpluses, the Legislature has had some inclination to make periodic adjustments in the standard deduction. Recent experience suggests, however, that the adjustments are less likely to be made during difficult times. Indexing of the standard deduction would ensure that the working poor would not be required to bear a disproportionate share of the state tax burden during periods of recession.

In addition to the obvious fairness gains from indexing the standard deduction, there are likely to be gains on administrative and efficiency grounds. As an alternative to itemized deductions, the standard deduction reduces administrative burdens on the Tax Department by inducing most taxpayers to forgo their itemized deductions. Over time, an unindexed standard deduction will become less attractive to some taxpayers, and the number of itemizers will increase.

120 This change in New York law is the result of the end of the capital gains preference under federal law.
121 See supra text accompanying note 83.
122 See infra note 127.
The efficiency gains from indexing the standard deduction are more theoretical. Taxpayers near the poverty line sometimes face the choice of working at a minimum wage job or going on welfare. The extent to which taxpayers on welfare actually have work alternatives is unclear. It is clear, however, that taxes imposed on those near the poverty line increase the economic incentive to choose welfare over work. That incentive effect is probably of minor significance at the state level. In any event, the generous low-income relief now provided to New York taxpayers has taken the working poor off the tax rolls. Keeping them off the tax rolls through indexing may help, to some modest degree, in keeping them off the welfare rolls.

An argument could be made for extending indexing to other fixed amounts set in the New York tax law.\textsuperscript{123} The basic argument is that tax increases, if they are to come, should be voted by the Legislature, not adopted \textit{sub silentio} through bracket creep or similar automatic mechanisms.\textsuperscript{124} The contrary argument is that indexing takes control over the timing of tax changes from the Legislature.\textsuperscript{125} It may be better policy, some commentators contend, for the Legislature to make periodic ad hoc adjustments in the rate brackets.\textsuperscript{126} Unfortunately, the Legislature's track record for making ad hoc rate adjustments is not good.\textsuperscript{127}


\textsuperscript{124} Id. at 13.

\textsuperscript{125} Id. at 19.

\textsuperscript{126} Id. at 23.

\textsuperscript{127} Prior to the TRRA of 1987, the last major adjustment in the first several tax brackets was made in 1935. See McIntyre, \textit{supra} note 6, at 277 n.1. Prior to 1986 the low-income relief thresholds had been adjusted upward by only small increments as reflected in the table below.

\textbf{TAX THRESHOLDS}

\textbf{MARRIED COUPLES & HEADS OF HOUSEHOLDS}

<table>
<thead>
<tr>
<th>Threshold Amount</th>
<th>Low-Income Allowance</th>
<th>Standard Deduction</th>
<th>Exemption Amount Individual</th>
<th>Exemption Amount Total</th>
<th>Household Credit Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975 5000</td>
<td>5000</td>
<td>1500</td>
<td>650</td>
<td>1300</td>
<td>0</td>
</tr>
<tr>
<td>1978 5200</td>
<td>5000</td>
<td>1900</td>
<td>650</td>
<td>1300</td>
<td>2000</td>
</tr>
<tr>
<td>1979 5300</td>
<td>5000</td>
<td>1900</td>
<td>700</td>
<td>1400</td>
<td>2000</td>
</tr>
<tr>
<td>1980 5400</td>
<td>5000</td>
<td>1900</td>
<td>750</td>
<td>1500</td>
<td>2000</td>
</tr>
<tr>
<td>1981 5500</td>
<td>5000</td>
<td>2000</td>
<td>750</td>
<td>1500</td>
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<tr>
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<td>1600</td>
<td>2167</td>
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<tr>
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<td>2750</td>
<td>850</td>
<td>1700</td>
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</tr>
<tr>
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<td>8000</td>
<td>3000</td>
<td>850</td>
<td>1700</td>
<td>2833</td>
</tr>
<tr>
<td>1987 9833</td>
<td>0</td>
<td>5300</td>
<td>900</td>
<td>1800</td>
<td>2733</td>
</tr>
</tbody>
</table>
A general indexing scheme is not necessary to preserve the integrity of the new rate schedules. The bracket widths have significant distributional implications, but it is the relationships between the brackets that is important for the design of a system of family taxation. A modest amount of bracket creep would not have much effect on those relationships.

B. Expanded Dependency Deductions

The reformed New York tax law provides for a dependency deduction of $1,000. This is an increase of $100 over the amount provided by the 1985 Tax Act. The amount prior to adoption of the 1985 Tax Act was only $800.

A major accomplishment of the federal Tax Reform Act of 1986 was the increase in the personal exemption to $2,000. New York, by greatly expanding the standard deduction, has in effect increased the personal exemption for the taxpayer and spouse by more than

<table>
<thead>
<tr>
<th>TAX THRESHOLDS</th>
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<tr>
<td>SINGLE TAXPAYERS</td>
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<tr>
<td>Threshold = Greater of: or</td>
</tr>
<tr>
<td>Threshold Amount</td>
</tr>
<tr>
<td>1975 2500</td>
</tr>
<tr>
<td>1978 4550</td>
</tr>
<tr>
<td>1979 4600</td>
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<td>1981 4917</td>
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<td>1983 4967</td>
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<tr>
<td>1986 5783</td>
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<tr>
<td>1987 6500</td>
</tr>
<tr>
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</tr>
<tr>
<td>1000</td>
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<tr>
<td>1400</td>
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<td>1400</td>
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</tbody>
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Under full income-splitting, the brackets of the rate schedule for married couples are twice as wide as the brackets of the rate schedule applicable to single persons. A change in the real size of the brackets of the singles rate schedule due to inflation would be matched by a proportional change in the brackets of the married couples rate schedule. A compacting of the brackets might be unfair, but it would be equally unfair to married persons and single persons. In a tax system that provides less than full income-splitting and thus produces some marriage penalty, a narrowing of the real width of the tax brackets due to the effects of inflation would exacerbate the marriage penalty by making it applicable to more taxpayers.

TRRA of 1987, supra note 2, § 68, 1987 N.Y. Laws at 102-03 (amending N.Y. Tax Law § 616(a)).

Act of Apr. 8, 1985, ch 29, § 29, 1985 N.Y. Laws 50, 63-64 (amending N.Y. Tax Law § 616(a)).

Id.

the amount of the new federal exemption. That is, the tax-free amount, computed by taking the sum of the taxpayer’s exemption and standard deduction, is greater for a married couple under New York law than under the Internal Revenue Code. Table 6, below, shows, however, that relief for taxpayers with many dependents is significantly less generous under State law than under the Internal Revenue Code.

The Staff of the Tax Study Commission proposed an increase in the dependency exemption to $1,500 for the first dependent and to $1,000 for additional dependents.\textsuperscript{133} The Staff took the position that the per capita share of family income going to children tends to diminish as additional children are added to the family.\textsuperscript{134} Limiting the increase in the dependency exemption to the first dependent would reduce revenue costs of the Staff’s proposal and would provide important relief to heads of households near the poverty line.\textsuperscript{135}

The adoption of generous low-income relief for heads of households has reduced the necessity for an expanded dependency exemption. It remains desirable on fairness grounds, however, that the tax burdens imposed on taxpayers above the poverty line take account of the reduction in their standard of living resulting from the sharing of resources within the family.

New York’s progressive rate structure is designed to provide for some redistribution of income. Some commentators have argued that generous dependency allowances undermine progression.\textsuperscript{136} They prefer that any allowances be given in the form of a credit in order to minimize the benefits otherwise granted to high-income families.\textsuperscript{137} The implicit assumption of such an argument is that redistribution should take place before, rather than after, voluntary redistribution.

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|c|c|c|c|}
\hline
Type of Household & \multicolumn{2}{|c|}{two} & \multicolumn{2}{|c|}{four} & \multicolumn{2}{|c|}{six} \\
\hline
\hline
Married Couple & 15,000 & 13,000 & 17,000 & 17,000 & 19,000 & 21,000 \\
Head of Household & 10,500 & 12,400 & 14,500 & 14,400 & 16,500 & 18,400 \\
\hline
\end{tabular}
\caption{TAX-FREE AMOUNTS FOR LARGE HOUSEHOLDS WITH DEPENDENTS, UNDER 1991 NEW YORK LAW (NY) AND 1988 FEDERAL LAW (US)*}
\end{table}

\* The federal tax-free amounts are indexed for inflation beginning in 1989.

\textsuperscript{133} See McIntyre, supra note 6, at 346.
\textsuperscript{134} Id. at 332-33, 346-47.
\textsuperscript{135} Id. at 346-47.
\textsuperscript{137} Id.
within the family. That assumption is unwarranted. An increase in
the dependency exemption is a simple and effective means for equal-
izing the tax burdens imposed on parents and other taxpayers who
enjoy comparable standards of living.

C. Refinements in the Joint Filing System

The distribution of burdens that will be produced under New York’s
reformed system of family taxation is very close to the results obtained
under a full marital income-splitting system. Because the per capita
standard deduction for married persons ($13,000/2) is $1,000 less
than the per capita standard deduction for single persons,\(^{138}\) there is
a modest departure from full income-splitting. The result is a marriage
penalty of up to $110 for married partners with aggregate income of
$15,000 or more who are claiming the standard deduction. There is
no penalty for couples with aggregate income below $13,000 because
those couples are entirely exempt from taxation. Nor is there any
penalty if the spouse with the lower income has taxable income of
less than $6,500. For married couples in the income range between
$13,000 and $15,000, the maximum marriage penalty is 5.5% of the
couple’s aggregate income over $13,000.

There is no marriage penalty for marital partners who itemize their
deductions. On the contrary, there is a very modest marriage bonus
of up to $30 for married couples with aggregate incomes over $25,000.
Assume for example, that H and W each has a separate taxable
income, of $20,000 after itemized deductions. They would pay taxes
of $2,425 if they filed separately. They would pay taxes of only $2,395
if they filed jointly on their aggregate income of $40,000.

Because penalties and bonuses are sufficiently small, they could be
ignored. The overwhelming majority of New York taxpayers will not
suffer any marriage penalty. Still, the marriage penalty is hard to
justify, especially at moderate income levels. Its elimination would
reduce an irritant that might cause policy problems in the future. If
the marriage penalty is eliminated, then joint filing need not be
mandatory because marital partners would obtain no advantage from
filing separately.

IV. CONCLUSION

To avoid heartbreak, farm children reportedly are instructed by
their parents not to make pets of the livestock. For the same reason,

\(^{138}\) See supra text accompanying notes 86-87.
tax analysts working on a tax reform project should not become too attached to their reform proposals. A simple fact of life is that most tax reform proposals end up on the slaughterhouse floor.

The reform of the New York system of family taxation has had an uncharacteristic outcome. Like the prize heifer the farmer's child was allowed to keep, the reform proposals advanced by the Staff of the Tax Study Commission survived the legislative process. They became the basis for the most sweeping reform of New York's personal income tax in its sixty-eight year history.

The proposals of the Staff of the Tax Study Commission were not the product of tax analysts working in isolation from the political mainstream. A draft of the Staff report received extensive comment from the Tax Study Commission's Policy Advisory Group, composed of prominent tax specialists from private practice, government service, and academia. It also was reviewed by the Staff of the Ways and Means Committee and by political leaders in the State legislature.189

When the proposals of the Staff of the Tax Study Commission became the basis for legislative action in 1987, they were subjected to the usual legislative process. They were reviewed by a wider circle of politicians and were refined by the tax technicians working for the legislature and the Governor. Ultimately, they were enacted into law without compromise of basic principles. The result is a coherent system of family taxation worthy of the wide political support it has received. When fully implemented, it should prove to be as simple and as fair as anyone could have dared wish when the tax reform process began in 1981.

189 The political leaders who advanced the reform effort have received most of the credit for its success. They deserve that credit, just as the mother rather than the midwife deserves most of the credit when a baby is born. A major figure was Stanley Fink, then Speaker of the Assembly. Fink was the moving force in creating the Tax Study Commission and was an important supporter of its work until his retirement from the Assembly in 1986. The contributions of other players are mentioned supra in section B of part II of the Article. Some notice should be made of the contributions of Richard D. Pomp and Frank Mauro in getting fundamental tax reform on the legislative agenda. Pomp, a law professor at the University of Connecticut, was the director of the Tax Study Commission from its founding in 1981 until his resignation in 1987, after passage of the TRRA of 1987. Because of his academic reputation, technical prowess, and political skills, he lent great credibility to the proposals coming out of the Tax Study Commission. They received the kind of attention from the leadership of the Legislature usually reserved for proposals of their own making. Mauro was for many years an important advisor to Speaker Fink, first as Director of the Assembly Program Development Group, and later as Secretary to the Ways and Means Committee. In the latter position, he served as the chief of the Assembly's staff of tax technicians. He enjoyed a reputation as a tireless worker and a brilliant political tactician. He developed the strategy that made the 1985 act a salient from which the battle for fundamental reform could be launched in 1987.