Taxing Families Fairly

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TAXING FAMILIES FAIRLY

Patricia A. Cain*

I. INTRODUCTION

Federal tax law and the tax law of an increasing number of states apply vastly different concepts of the family for purposes of assessing taxes. Federal tax law, for example, does not recognize same-sex marriages from the Commonwealth of Massachusetts.¹ Nor does it recognize civil unions from Vermont, Connecticut, New Jersey, and New Hampshire, statewide domestic partnerships from California, Oregon, Maine, and Washington, or reciprocal beneficiary relationships from the State of Hawaii.² In six of these states that recognize same-sex partnerships, the partners file joint returns at the state level and are generally subject to the same state income tax rules as married couples.³ At the federal level, these same people must file as single taxpayers.⁴ This difference between federal and state law is a

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¹ See Defense of Marriage Act (DOMA), 1 USC § 7 (2000) (providing that same-sex marriages shall not be treated as marriages for purposes of federal law).

² No one has yet brought an appropriate challenge to the tax laws claiming that civil unions or domestic partners should be treated as spouses. A couple from Illinois did try to claim an equal protection violation for failure of the tax statutes to recognize them as spouses, but their claim suffered from the fact that they were not in any sort of state-sanctioned relationship. Mueller v. Comm’r, No. 02-1189, 2002 WL 1401297, (7th Cir. June 26, 2002). The taxpayer, appearing pro se, appeared to be challenging the Defense of Marriage Act (DOMA), but the Court of Appeals held that DOMA was simply not implicated because the couple was not married, nor had they attempted to have their relationship recognized by the state as a marriage. Id.

³ The six states authorizing joint returns are Massachusetts, Vermont, Connecticut, New Jersey, Oregon, and California. Neither New Hampshire nor Washington has a state income tax. Hawaii is considering whether to extend joint return filing to reciprocal beneficiaries. Maine does not offer joint filing to unmarried couples.

⁴ As single taxpayers, they may also be entitled to file as “heads of
recent occurrence. It is creating excessive burdens on same-
sex couples and on state taxation authorities. It is also
completely out of line with a long history in the federal tax
law of recognizing relationships and property rights under
state law.

The federal government’s refusal to recognize the
statuses of same-sex partners, which have been created by
state law, can only be corrected by legislation at the federal
level. The reasons for supporting such a legislative remedy
are: (1) to eliminate uncertainty in the federal tax law, (2) to
reduce the burden on state taxing authorities, and (3) to
ensure that all couples are taxed accurately and fairly.

This article will review the history of federal tax law’s
recognition of the family unit as well as the role of state law
in federal tax decisions. It will then focus on the various
state law regimes that recognize new family statuses that
remain unrecognized at the federal level, identify some of the
key differences in tax treatment, and dispel the myth that
taxing couples as married is intended to benefit or support
the marital unit. It will conclude with suggestions about
possible solutions to the problem that has been created by the
tension between federal and state law.

II. TAXATION AND THE FAMILY: A BRIEF HISTORY

Marriage and family relationships matter in tax law.
How much they should matter is a subject of great debate
among tax scholars. As Boris Bittker wrote in 1975, “[a]
persistent problem in the theory of income taxation is
whether natural persons should be taxed as isolated
individuals, or as social beings whose family ties to other

households” if they meet the requirements. See I.R.C. §§ 1(b), 2(b) (2000)
deﬁning head of household and providing the rates).

5. Theoretically, a federal court could strike down individual tax statutes
on equal protection grounds if a married couple in Massachusetts ﬁles a lawsuit
challenging DOMA. Similarly a federal court could strike down on equal
protection grounds an individual tax statute that treats spouses differently from
similarly situated partners in a civil union or domestic partnership. But, these
actions would have to occur in individual taxpayer suits in which the speciﬁc
statute or statutes had been applied to tax the couple differently from married
couples. Given the limitations on challenges to the federal tax law, a civil-rights
litigation strategy to challenge the entire Internal Revenue Code’s treatment of
same-sex couples would not be possible. See, e.g., I.R.C. § 7421 (2000)
(prohibiting suits to restrain assessment of collection of tax except in limited
circumstances).
taxpayers affect their taxpaying capacity." This problem poses at least three issues for families: (1) Should families aggregate their income and deductions and report taxable income as a single unit? (2) Should transactions between family members be accorded the same tax consequences as market transactions between unrelated taxpayers? (3) How should the tax law account for intra-family transfers that occur as a result of state-imposed obligations of support and property division?

A. Family Aggregation of Income and Deductions

History shows us that Congress did not consider the question of whether family members should be taxed as a unit or as individuals when it adopted the modern income tax in 1913. Congress made a simple decision at that time: income taxes would be assessed against individuals. Furthermore, each individual taxpayer would be subject to the same progressive rate schedule.

The early revenue acts contained no provisions addressing the effect that marriage or family responsibilities would have on taxpaying ability, except for the allowance of an additional $1000 personal exemption if the taxpayer was married. Four years later, in 1917, a dependency exemption of $200 for each child was added. Joint returns became optional in 1918, but they were for convenience only.

The debate over whether to tax individuals or family units arose in the United States in response to a number of
hotly contested tax cases involving the attribution of income between husbands and wives. These cases were resolved on the basis of state family law and property law. Community property rules, married women's property acts, spousal control over property and income, and family support obligations all played a part. In sum, the move away from taxation of individuals to a norm that treats the married couple as the taxpaying unit resulted primarily from the differences between state laws and the federal government's desire to accommodate these differences.

1. The Move from Separate to Joint Returns

The Sixteenth Amendment authorizing an unapportioned income tax was adopted on March 1, 1913. That October, Congress passed an income tax statute that taxed income at the rate of one percent. A one percent surtax was applied to incomes above $20,000, increasing in one percent increments to a maximum surtax of six percent on net incomes above $500,000.12

In 1913, there were no joint returns. A 1914 pair of Treasury Decisions clarified that husband and wife were to file separate returns reporting their separate incomes.13 An optional joint return was introduced in 1918, which allowed husbands and wives to file a single return and report aggregate income and deductions.14 This option provided a desirable convenience for those taxpayers whose combined income was below the amount that would trigger the surtax rate.15 However, with the increase in rates that occurred in

15. In 1918, a huge increase in rates was enacted in order to help finance World War I. The normal tax was set at six percent on net income of $4000, with a surtax of twelve percent on amounts in excess of $4000. Additional surtaxes were imposed ranging from one percent to sixty-five percent, creating a top marginal bracket of seventy-seven percent. Combining incomes of husband and wife provided the aggregate income amount was below $4000 would avoid the progressivity of the higher surtaxes. See Lindsey, supra note 12, at 13-14
1918, joint returns that aggregated spousal incomes were not attractive to high-income taxpayers. Instead, the 1918 rate increase encouraged high-income taxpayers to seek even more aggressively the benefit of splitting income between spouses. In community property states, spouses took the position that community income was owned equally by the spouses and thus could be split between them for purposes of reporting income.

a. Treasury's Initial Position on Community Earnings

In 1920, the Internal Revenue Service issued Office Decision No. 426, authorizing spouses in two community property states, Texas and Washington, to file separate tax returns, with each spouse reporting half of the income from community property. Community earnings from spousal labor, however, were not to be split for tax purposes. Community property spouses argued that they should also be allowed to split earnings. In 1920, the Attorney General concluded that husbands and wives in Texas could split the husband's earnings equally between them in their separate tax returns. Early in 1921, the Attorney General issued a further opinion concluding that spouses in all of the eight community property states, except California, could split the husband's earned income and allow the wife to report her half separately as her income.
Now it was the spouses in non-community property states who complained. Almost immediately a bill was introduced in Congress that would have required community income to be included in the “gross income of the spouse having management and control of the community property.” In all of the community property states, husbands had management power over the community assets and income. Such a statute would have taxed all community income to the husband no matter whose efforts created the income and no matter how vested the wife’s rights in the community property. In non-community property states, by contrast, the passage of married women’s property statutes had given wives management power over their own earnings. Under the proposed “management and control” standard, spouses in common law property states would have been entitled to file separate returns, with each spouse reporting his or her own earned income. As a result, spouses in these states would pay taxes at a lower rate than similar two-earner couples in community property states. Although introduced several times, this bill never passed.23

b. The California Problem

As early as 1918, California spouses had reported community earnings on separate tax returns, and they continued to do so into the 1920s, even after the Attorney General had ruled that California community property laws did not vest the wife with sufficient ownership over community income. Some spouses claimed that the community property laws entitled them to such a reporting position despite the Attorney General’s decision to the contrary. Others accepted the law as set forth by the Attorney General and entered into spousal agreements that recharacterized all spousal earnings as the separate property of the earning spouse. Or, in some cases, spouses entered into a more limited agreement in which they agreed that the earnings of the wife would be her separate property.24

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23. *Id.* at 153 (discussing Revenue Acts of 1923 and 1924).
24. As a result of such agreements, the wife claimed ownership of her own from her husband’s labor. *Id.*
Commissioner challenged these agreements between California spouses and taxed all community income to the husband on the theory that he, as the manager of community assets, maintained control over all community income. But the agreements were valid under state law. They did in fact transform what had once been community property into separate property. Based on the validity of these agreements under California law, the Board of Tax Appeals began to tax the wife's earnings to the wife rather than the husband, whenever the spouses had agreed that her earnings would be her separate property.25

In 1918, California taxpayer Reuel D. Robbins and his wife, Sadie, filed separate tax returns, each reporting one-half of the community income. All income was derived from community property and the earnings of Mr. Robbins. Thus began a test case, challenging the 1921 Attorney General's opinion as applied to California spouses.

The United States argued that California law controlled and that under California law the wife had a mere expectancy. Thus, she could not be considered the "owner" of the income for tax purposes. Federal District Court Judge Partridge, in a lengthy and lucid opinion, explained that, although California courts had so described the wife's interest, the substance of the California law in fact created in the wife an interest just as vested as the interest of wives in the other seven community property states.26

No California court had ever determined that the wife was not a sufficiently vested owner to make half the community income hers for federal tax purposes. Nor had the United States Supreme Court so ruled. Nor had the Court of Appeals for the Ninth Circuit. In the absence of binding precedent, Judge Partridge determined that California spouses were entitled to split community income for federal tax purpose, explaining that "[i]t is the marriage which creates ownership; death or divorce merely give possession."27 He ruled in favor of California taxpayers despite the...

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25. See, e.g., Gassner v. Comm'r, 4 B.T.A. 1071, 1072 (1926); Harris v. Comm'r, 10 B.T.A. 1374, 1375 (1928).
27. Id. at 705.
government's plea that to do so would cost the federal fisc over seventy-seven million dollars in the form of tax refunds to California spouses.

Robbins v. United States was appealed directly to the United States Supreme Court. This was the first opportunity for the Court to speak on the question of income splitting in community property states. The government argued narrowly that California wives were insufficiently vested in community income. Justice Holmes, writing for the majority, agreed, noting that California, unlike New Mexico, did not require the consent of both spouses to all conveyances of community property. However, he made no reference to any other distinctions between California and other community property states; totally ignoring the fifteen page decision from the lower court that had detailed such distinctions and concluded that they were more apparent than real. Holmes ended his brief, three-page opinion, with the following observation:

Even if we are wrong as to the law of California and assume that the wife had an interest in the community income that Congress could tax if so minded, it does not follow that Congress could not tax the husband for the whole. Although restricted in the matter of gifts, etc., he alone has the disposition of the fund. He may spend it substantially as he chooses, and if he wastes it in debauchery the wife has no redress. . . . That he may be taxed for such a fund seems to us to need no argument. 28

c. Treasury Takes a New Position

Robbins was the first Supreme Court opinion to address the issue of income-splitting in community property states. Justice Holmes delivered an opinion that seemed to counter the Attorney General's 1920 opinion about community property spouses in the other seven community property states. In that opinion, Attorney General Palmer had reasoned that the community of husband and wife was similar to a partnership of equals. As to the husband's control over the property, the Attorney General had concluded: "And though the management and disposal of community property during marriage are usually given to the

husband, this is said to be for reasons of public policy and social economy, and not on the grounds that the husband has any greater interest than the wife.\textsuperscript{29} Holmes, by contrast, was suggesting that the husband’s ability to manage and dispose of community funds was a sufficient lynchpin for taxation. Control by husbands was the rule in all community property states.\textsuperscript{30} In response to the Holmes opinion, in 1926 Treasury officials began to reconsider their position permitting income-splitting by spouses in the other seven community property states. They proposed to tax husbands on all community income on the basis of the ability to manage and control.

Not surprisingly, taxpayers from those seven states and their representatives in Congress responded quickly to the notion that Treasury would reconsider its long-vested policy. In response, Attorney General Sargent announced that he would hold public hearings on the matter at which he would allow taxpayers and their representatives to state their views.\textsuperscript{31} These hearings ultimately resulted in a new opinion by the Attorney General\textsuperscript{32} in which he acknowledged that all community property states were different, withdrew the earlier opinions in favor of the seven community property states, and indicated that the ability to split income on the basis of state law would be determined in a series of test cases that would eventually reach the United States Supreme Court. A key point in this opinion was that “[d]ecisions of the state courts holding what rights of a proprietary nature the wife may exercise in respect of community income are binding on the court.”\textsuperscript{29}

\begin{footnotes}
\item[30.] Louisiana did not abandon the rule that the husband was “head and master” of the community estate until 1980. See Kirchberg v. Feenstra, 450 U.S. 455 (1981) (holding pre-1980 Louisiana law violated the Equal Protection Clause). Texas did not give wives meaningful control over community property until 1967. See Joseph W. McKnight, Texas Community Property Law—Its Course of Development and Reform, 8 CAL. W. L. REV. 117, 131 (1971). By contrast, in most common law property states, the effects of coverture had been chipped away by the passage of married women’s property acts and earnings statutes, which gave married women some control over their own earnings. See Reva B. Siegel, The Modernization of Marital Status Law: Adjudicating Wives’ Rights to Earnings, 1860-1930, 82 GEO. L.J. 2127 (1994) (discussing early statutes and their narrow construction in litigation).
\item[31.] Donworth, supra note 13, at 164.
\end{footnotes}
Because each state had its own rules regarding the wife's interest in community property, it would be necessary to bring a test case for each of the eight community property states.

d. The Test Cases

In August of 1928, spouses from four community property states, Arizona, Louisiana, Texas, and Washington, filed test cases in federal district court. In every case, the spouses had reported community income by allocating half to the husband and half to the wife. In every case, the Internal Revenue Service refused the returns and instead assessed a tax against the husband, allocating 100% of the community income to him. The husbands in each case paid the tax and sued the local Collector of Internal Revenue in federal district court, claiming a refund in the amount of the additionally assessed tax. Ultimately these cases were consolidated and heard by the Supreme Court. In the lead case, taxpayer/husband Seaborn sued Burns Poe, the Collector of Internal Revenue for the District of Washington.

The government argued in Poe v. Seaborn that the community property laws of the State of Washington gave so much control over community property and income to the husband that he should be the one to bear the tax. This position was a complete reversal of the earlier position of the Attorney General, which had held that all community property states, other than California, gave the wife a sufficiently vested interest in community property and income to tax her on half. The Holmes opinions in Robbins, emphasizing control, supported the government's position in Seaborn. The government also argued that federal tax laws were intended to operate uniformly and that the tax burden should fall equally on the family unit regardless of whether the family lived in a community property state or not.

Ultimately the Supreme Court agreed with the taxpayers in Seaborn that the tax should be borne by the owner of the income. Since wives had a vested property right in

33. Id.
36. Id.
community property they were co-owners with their husbands and thus should be taxed on half the community income from property. Because wives had a similar vested right in the community earning produced by a husband’s labor, she was to be taxed on half of earned income as well.

The companion cases from Arizona, Texas, and Louisiana all held in favor of the taxpayer on the same grounds. All were decided on November 24, 1930. Just two months later, on January 19, 1931, the Court extended the income-splitting rule to California spouses as to community property income derived in 1928 and later. From this point on, absent legislative intervention by Congress, spouses in community property states could split income and thereby pay a lower tax bill than spouses with the same amount of combined income would pay in common law property states. Income splitting between spouses outside of the community property system had been denied in the case of Lucas v. Earl, decided shortly before Poe v. Seaborn. In Earl, the spouses had agreed to share all of their income and property jointly. The agreement was fully enforceable under state law. Nonetheless, Justice Holmes, writing for a unanimous Court, opined that such assignments of earned income could not be recognized by the tax law. The assignor would continue to be taxed on the assigned earnings despite the validity of the assignment under state law.

e. The Aftermath

The tension created by the difference in tax treatment between spouses in community property states and spouses in other states eventually led to the enactment of joint returns. Congress had several options: (1) they could overrule Poe v.
Seaborn and tax earned income in community property states to the earner rather than allowing it to be split; (2) they could overrule Lucas v. Earl, and tax income that spouses had agreed to share half to one spouse and half to the other; or (3) they could take some middle road that would reduce the difference between community and non-community property states.

In 1933, a subcommittee of the House Ways and Means Committee issued a preliminary report making no recommended change “in view of the legal difficulties involved.” In 1934, Acting Secretary of the Treasury Morgenthau recommended consideration of compulsory joint returns for all spouses, but the recommendation was not enacted. In that same year, Representative Treadway introduced a bill similar to the ones rejected by Congress in 1921 and 1924 requiring community income to be taxed to the spouse with management and control. This solution was deemed simpler than a compulsory joint return and was supported by the Treasury, but it was never passed.

In 1937, President Roosevelt addressed the Congress on the issue of tax evasion, citing the division of community income as a primary cause of revenue loss. In 1941, the Treasury again proposed a compulsory joint return for all spouses aimed at mitigating the community property problem as well as reducing the ability of other spouses to arrange their affairs in ways that would reduce tax revenues. The proposal would have required spouses to pay a tax on their aggregate income at the same rate that a single person would have paid on the same amount of income. The result would have been to increase the tax burden on almost all married couples. As a tax on marriage, the proposal was attacked on moral grounds and was ultimately defeated.

Common law property states responded to the concerns of their citizenry by proposing community property legislation
intended to gain for their spouses the same benefits available to spouses in the eight community property states. Oklahoma, Oregon, Hawaii, Nebraska, Michigan, and Pennsylvania became, for at least a short time, community property states. In 1948, Congress responded to the problem with the enactment of the modern joint return. Under this approach, spouses would aggregate income, but the tax paid would be "equal to twice what a single person would pay on one-half" of such income.\textsuperscript{48} This option satisfied numerous concerns. For one thing, once the Supreme Court of the United States had held that half of all community earnings \textit{belonged} to the non-earning spouse, some in Congress were afraid to tax those earnings to the non-owning spouse. Why? In 1931, the Supreme Court had held in \textit{Hoeper v. Wisconsin}\textsuperscript{49} that it was a violation of due process to tax one spouse on income that was owned by the other spouse. In addition, the eight community property states were quite populous and powerful. Thus, adopting an option that would have repealed income-splitting for community property spouses was simply not politically feasible. The joint return alternative, by contrast, could appeal to everyone because it had the effect of extending the benefit of income-splitting to all spouses.

The point here is that the joint return was not adopted by a Congress that had studied the pros and cons of taxing the family unit rather than taxing the individual family members. It was not adopted because Congress embraced the notion of the family unit as the "correct" tax unit. It was adopted solely in response to the political outburst by taxpayers in non-community property states and because no other solution was thought viable.\textsuperscript{50}

2. \textit{Refining the Rate Structure}

In response to subsequent bickering by single taxpayers, especially those with dependent children who argued that they should be allowed to split income with their family members, Congress has continued to refine the rate structure

\textsuperscript{48} \textit{Id.} at 1412.
\textsuperscript{49} \textit{Hoeper v. Wisconsin}, 284 U.S. 206 (1931).
to account for varying family responsibilities and benefits. In 1951, special rates for taxpayers who qualified as "heads of households" were introduced. These rates were set halfway between those for single taxpayers and married taxpayers filing jointly thereby acknowledging the additional family responsibilities of such taxpayers. In 1968, Congress made another adjustment to the rates to reduce the disparity between single and married taxpayers. This adjustment was required to account for the benefits that married couples experienced in the form of lower household expenses due to economies of scale and the tax-free imputed income of spouses who provided valuable household services. Single taxpayers were presumed to live alone and thus not experience comparable benefits. The new rate structure was designed so that single taxpayers would never pay more than 120% what a married couple would pay on the same amount of income.

Today the rate structure differentiates among several different types of families. Married couples aggregate income and file using one rate schedule. The rate schedule is not adjusted for the number of children or other dependents in the family. Single taxpayers living with dependents do not aggregate income, but they do file using a different rate schedule designed specifically for them and giving them a benefit equivalent to income splitting. Other single taxpayers, no matter what sort of household or family arrangement they have, file using still a different rate schedule. This rate schedule was designed to tax them solely on their own income and was grounded on the assumption that single taxpayers live alone and do not enjoy economies of scale or other similar benefits that married couples enjoy.

3. The Problem

This additional tinkering with the rates has created what many commentators now call the marriage tax penalty.

51. See Bittker, supra note 6, at 1417.
52. The specific definition of "head of household" has varied since 1951, but it generally requires the taxpayer to maintain a home for the taxpayer and a child or other dependent. See I.R.C. § 2(b) (2000).
53. See Bittker, supra note 6, at 1422-29.
54. The tax base is adjusted for children and dependents through the allowance of exemptions. See I.R.C. § 151 (2000).
55. Over the years there has been a significant shift in the number of tax returns filed by married couples filing jointly and by single people. While there
When a marital unit consists of two earners the spouses will now pay a slightly higher tax if they report as married taxpayers than they would if they divorced and reported as single taxpayers. This problem has been the focus of most tax scholarship about the family since the mid-1970s, although the problem is minimized when rates are less progressive, as they have been in recent years. Nonetheless, the refinement of the rate structure in an attempt to be fair to different types of households has created a cry for tax rates that do not discriminate on the basis of marital status.

The main hurdle in establishing a marriage neutral tax system is not the joint versus single return. A fair tax could ignore marriage in setting rates by taxing each individual according to a single rate schedule. Taxing every individual according to the same rate schedule, however, would reintroduce the problem that led to joint returns in the first place, that is the problem of determining who reports how much of the combined family income and deductions. I call this the problem of income allocation. It arises in the context of family households because there are often joint ownership rights to the income as well as equitable claims to its

are many social and economic explanations for this shift other than the marriage tax penalty, it is likely that the penalty has contributed to this shift. In 1971, seventy-eight percent of total AGI was reported on joint returns and only sixteen percent by single, non-head of household, taxpayers. Bittker, supra note 6, at 1427. In 2005, sixty-seven percent of total AGI was reported on joint returns and twenty-four percent was reported by single, non-head of household, taxpayers. See Table 1.2--All Returns: Adjusted Gross Income, Exemptions, Deductions, and Tax Items, by Size of Adjusted Gross Income and by Marital Status, Tax Year 2005, IRS Statistics of Income web page at http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96978,00.html(last visited April 11, 2008).


57. In addition, in 2001, Congress offered some relief for married taxpayers in the lowest tax bracket by broadening the fifteen percent bracket for such couples in order to avoid the marriage tax penalty.

58. For example, earnings in community property states are owned by both spouses. See Poe v. Seaborn, 282 U.S. 101, 111 (1930). But even in non-
benefits.  
Solutions to this problem are possible. For example, allowing all couples to determine their own allocations is a solution that would treat all couples the same, whether they are married or not. This solution would be consistent with a principle of honoring individual choice, but it would not tax all couples with the same income at the same rate because the couples would have the power to choose allocations that would result in different rates of tax. A possible critique of this solution is that extending the ability to allocate too broadly will threaten progressivity.

In sum, the rate structure is not the only issue that affects fair family taxation. The more difficult issue is how to determine the appropriate tax base for each individual taxpayer in a marriage or similar status grounded in financial interdependency. Should income and deductions be aggregated by spouses or should they be allocated between spouses? If we are to attain a true marriage neutral tax system then should we include unmarried couples in the same aggregation or allocation rules? Which couples should we include? If we opt for voluntary allocation, how can we ensure that the allocations have economic substance? I will

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59. Obligations of support create equitable claims by one spouse to the income or property of the other if needed for support purposes. And the equitable division at divorce rules give a non-titled spouse a strong equitable claim to the property owned by the titled spouse.

60. E.g., if partners A and B decided to pool all income and deductions, then their tax liability as individuals should be calculated in accord with this decision. They could report all income and deductions on an information return, much like a partnership return and then report individually fifty percent of the net taxable income. By contrast, if partners C and D elected to keep their salaries separate but share everything else equally, they should aggregate all other income and deductions, compute a bottom line amount and add that amount (or subtract it if negative) from the salary reported on their W-2s to determine individual income.

61. See Bittker, supra note 6, at 1396 (identifying three basic principles of tax law: (1) progressivity, (2) equal taxes on equal-income married couples, and (3) a marriage neutral tax burden). As Bittker demonstrates, it is impossible to have all three principles in a single system. The proposed solution in the text maintains the first and the third principles, although it does create some risk for progressivity. It only violates the second principle by giving choice to the taxpayers which seems a minimal violation since it gives equal choice.
return to these questions in Part V of this Article.

B. Property Transfers Between Spouses

There is another issue that is central to taxation of the family, an issue that is related to the question of how income and deductions should be allocated in family units. This issue involves the tax treatment of property transfers between spouses and partners, or other family members. Thus, this section will explore the history of how wealth transfers between spouses have been taxed over the years and identify the problems created by not extending similar rules to unmarried couples.

1. Gift and Estate Tax

Wealth transfers from one person to another, absent adequate consideration, constitute taxable gifts. The treatment of gifts between spouses as taxable under the gift tax created another advantage for community property spouses as compared with spouses in common law property states. Since community property was viewed by the tax law as owned equally at the moment it was acquired, husbands who were sole earners essentially vested their wives with fifty percent of their earnings without ever having to pay a gift tax. A gift tax is imposed on "transfers" of property and under Poe v. Seaborn, the tax law did not view the creation of community property as a transfer. Husbands in common law property states, by contrast, would be viewed as making a taxable gift to their wives if they transferred to them fifty percent of the husband's earnings after it first vested in the husband. This result is consistent with the analysis in Lucas v. Earl, which viewed voluntary income-sharing agreements between spouses as "transfers" of property. To remedy this

63. See I.R.C. § 2501 ("A tax . . . is hereby imposed . . . on the transfer of property by gift . . . .").
64. See also Estate of DiMarco v. Comm'r, 87 T.C. 653 (1987) (holding that where taxpayer's employer subjected employees to a plan under which at the employee's death certain payments would be made to the surviving spouse, there was no "transfer" by the taxpayer employee). This case is consistent with the situation of community property spouses who are subjected to a property regime under which property interests are involuntarily vested in each spouse and not transferred from one spouse to another.
65. Presumably the contract between Mr. and Mrs. Earl created transfers of
discrepancy between community property and non-community property spouses, in 1948, along with the adoption of joint returns, Congress adopted a fifty percent marital deduction for spousal gifts of separate property.\footnote{6}

A similar advantage for community property spouses occurred under the estate tax. Because community property spouses each own only half of the community estate, upon the death of either spouse, only half of the property would be included in the gross estate. Thus an estate tax marital deduction was required to create the requisite equality of treatment for non-community property spouses. The 1948 Act included such a provision, authorizing spouses in common law property states to claim a marital deduction of up to fifty percent of the separate property in the gross estate, provided the property was transferred to the surviving spouse.\footnote{67}

In 1981 Congress moved closer to the concept of a single “marital tax entity” by increasing the fifty percent marital deduction to one hundred percent. Stanley Surrey had argued for this sort of treatment for spousal transfers as early as 1948.\footnote{68} Critics of the one hundred percent marital deduction emphasize the fact that it is overbroad and provides too large a benefit to spouses who may not have been part of the marital entity that accumulated the property that is ultimately transferred at death.\footnote{69} However, the one

\footnote{66. This fifty percent marital deduction put common law property states on a par with community property states in the following situation: Husband as the earner acquires property and then transfers a fifty percent ownership interest to wife. At the end of the transaction, both spouses own the property equally, as do community property spouses, and there is no transfer tax assessed on the transfer.}

\footnote{67. See Surrey, \textit{supra} note 50, at 1115 (describing the 1948 Act).}

\footnote{68. As he explained:}

\footnote{[A] wife, already deprived of a husband’s earning power should not be forced to a still lower standard of living through sharing with the Government the capital accumulation of the husband. This attitude is not generally held with respect to the children . . . . I would apply the principle of complete elimination of interspouse transfers from the transfer tax base both to outright transfers to a spouse and to transfers in which the spouse had an immediate beneficial interest in the property. Thus, property left by a husband to his wife for life, remainder to the children, would not be taxed at his death. Surrey, \textit{supra} note 50, at 1116.}

\footnote{69. See, e.g., Joseph M. Dodge, \textit{A Feminist Perspective on the QTIP Trust and the Unlimited Marital Deduction}, 76 N.C. L. REV. 1729, 1740-41 (1998)}
hundred percent deduction does make sense for long-term couples who have acquired property that contributes to a shared standard of living (e.g., personal residences, vacation homes, art work, antiques, as well as cash that is available for current consumption). They rightly think of such property, accumulated over the years, as theirs. In such cases, when the first spouse dies, it seems inappropriate to the surviving spouse for the Federal Government to assert a claim to approximately one quarter of the jointly accumulated wealth. The new marital deduction rules effectively treat all married couples as a single entity by not assessing transfer taxes until the property is transferred outside the marital unit.

2. Income Tax

Transfers of property in exchange for consideration are generally taxable sales, producing either ordinary income or capital gains, depending on the type of property transferred. In the first seventy years or so of the modern income tax, transfers between spouses were generally taxed on the same basis as transfers between strangers. The possibilities for spousal manipulation of these rules to the detriment of the Treasury led to piecemeal legislation that limited the most blatant abuses, but did not repeal the general rules. Thus, for example, when spouses sold to each other at a gain, they would be taxed, but when they sold to each other at a loss, the loss deduction would be denied. Another restriction on spousal transfers that was enacted to prevent abuses was the rule that if one spouse sold an asset to another spouse that would be depreciable in the hands of the purchasing spouse, then the selling spouse would have to report the gain on the

(claiming that the fifty percent deduction is the most generous deduction that can be justified normatively on the basis of a presumption that spouses share marital wealth in the same way that community property regimes presume spouses share community property).

70. With a marital deduction of only fifty percent and a marginal estate tax rate of approximately fifty percent, the fifty percent marital deduction would result in the government claiming approximately twenty-five percent of the wealth transferred from the title-holding spouse in a common law property state to the other spouse. This would be true only after subtracting out the exemption amount which for 2008 is two million dollars.

71. Internal Revenue Code section 267 used to limit losses on transfers between spouses during the marriage, but not after divorce. However, this section has been pre-empted by section 1041. See I.R.C. § 267(g) (2000).
sale as ordinary income rather than capital gain. This rule prevents the spouses as a single economic unit from trading a capital gain taxed at a lower capital gains rate for a depreciation deduction which would offset ordinary income. As a result, spouses were sometimes considered a single economic tax unit, but often were not. These anti-abuse rules applied equally to spouses in community property and common law property states.

The distinction between community property and non-community property states, however, became a burning issue under the income tax in 1962 with the Supreme Court decision in United States v. Davis. In Davis, the Court held that a divorcing husband's transfer of appreciated property to his wife triggered a taxable gain to him. Because the Davises resided in a state in which the wife held no vested rights in marital property, the transfer of property was thought to resemble a taxable sale more than a non-taxable division of jointly owned property. Post-Davis litigation established a rule, eventually adopted by the IRS, that in community property states as well as in those common law property states that gave the wife a quasi-vested equitable interest in marital property, transfers between spouses at divorce would not be taxable events if they involved essentially equal divisions of jointly owned assets. But for spouses in all other states, divorce became a potentially taxable event.

In 1984, Congress remedied the problem for spouses in those states by enacting section 1041. Under this provision, no spousal transfer of property, either during marriage or after a divorce, will result in a gain or a loss to the

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74. Mrs. Davis released her marital rights as consideration for the transfer to her of stock by Mr. Davis. Mr. Davis was taxed as though he had sold the stock to Mrs. Davis in exchange for the fair market value of her released marital rights. The spouse who releases marital rights, however, is not taxed on the transfer. Rev. Rul 67-221, 1967-2 C.B. 63. While this ruling provides no rationale for this position, one possibility is that a spouse such as Mrs. Davis is merely receiving funds that replace her right to support and future inheritance, both items that she would have been entitled to enjoy tax-free.
76. Transfers to ex-spouses are covered by this provision so long as the transfers are "incident to divorce." I.R.C. § 1041 (2000). The section also provides that the transferee spouse takes the basis of the transferor spouse, which ensures that the gain or loss will be recognized upon final disposition by
transferring spouse. The effect of this provision is to merge the two individual taxpayers into a single taxable entity in which transfers are simply accorded no economic effect for tax purposes.

3. The Problem

The current wealth transfer rules effectively treat all married couples as a single tax unit. As with joint returns, which similarly treat spouses as a single unit, the driving force that led Congress to this solution was the goal of uniform taxation of spouses who had been taxed differently under state property law. Thus, under current law, the problem of geographical differences has been resolved for spouses.

It is unclear, however, how unmarried couples will be treated when they dissolve their relationships and enter into agreements about the division of property. If the pre-1984 law that was applicable to spouses can also apply to unmarried couples, then those couples who own property jointly should be able to divide their property when they split up without facing adverse tax consequences. Applying the same pre-1984 principles developed in litigated cases would produce a nontaxable division of property no matter whose name is on the title, at least in those states that accord certain unmarried couples vested property rights. However, there is no direct authority dealing with unmarried couples, and so the outcome is less than clear.

the transferee spouse. See I.R.C. § 1041(b).

77. And there is no reason to suppose that the rules should be different simply because a couple is unmarried. The pre-1984 law that was applied to spouses was derived from rules about joint ownership unrelated to marriage. Thus, for example, joint owners who partition their joint ownership into separate ownership interests do not usually recognize gain or loss. The theory is that there is no realization event in such cases. See Rev. Rul. 56-437, 1956-2 C.B. 507 (partition of one parcel into two parcels); I.R.S. Priv. Ltr. Rul. 93-27-069 (July 9, 1993) (holding that Rev. Rul. 56-437 applies to co-tenants who divide up contiguous co-tenancy parcels into separately owned parcels).

78. See Walz v. Comm’r, 32 B.T.A. 718 (1935); Carrieres v. Comm’r, 64 T.C. 959 (1975), acq. in result 1976-2 C.B. 1, aff’d per curiam, 552 F.2d 1350 (9th Cir. 1977).

79. For example, California grants registered domestic partners the same vested community property rights as spouses enjoy.

80. But see Reynolds v. Comm’r, 77 T.C.M (CCH) 1479 (1999), holding that an annual payment of $22,000 pursuant to a settlement agreement in which unmarried cohabitants of twenty-four years agreed that she would release all
Under estate and gift tax rules, however, the law is clear. Marital deductions are only available to spouses. Thus, lifetime gifts and death-time transfers that are above the exemption amounts\(^8\) will trigger transfer taxes for unmarried couples, and, so long as DOMA remains effective, will also trigger transfer taxes for same-sex spouses.

Unmarried couples could be treated the same as married couples provided they have formed a similar economic unit. Certainly those couples who have registered in states that recognize domestic partnerships and civil unions on a basis that is close to marriage would appear to be the sorts of couples whose transfers should be controlled by section 1041. To treat such couples as legal strangers under the income tax law merely gives them the opportunity to create tax avoidance schemes that are unavailable to spouses\(^8\) and taxes them on transactions that lack true economic substance. And to treat them as legal strangers under the estate and gift tax law results in the assessment of a tax on the transfer of property that, in many cases, the transferee already owns.\(^8\)

81. The lifetime exemption for gifts is one million dollars. The exemption for the estate tax is currently two million dollars. The exemptions must be cumulated. Thus, a person who makes a lifetime taxable gift of one million dollars would only have a one million dollar exemption at death for the estate tax.


83. This problem is particularly acute in the case of property held as joint tenants with right of survivorship. Section 2040 includes 100% of the joint property in the estate of the first to die unless the surviving tenant can prove original contribution. Thus, if A gifts property to B and B uses that gift to purchase joint tenancy property with A, B (as the beneficiary of A's estate) will bear the estate tax on 100% of the property at A's death even though she owned
A fair tax for all families should treat similarly situated families the same with respect to the taxation of property transfers. The primary problem in crafting a fair rule is determining which families or couples are similarly situated. I will return to this problem in Part V.

C. Support Payments

1. Overview of the Law

All states generally impose some duty on spouses to support each other. While this support obligation is generally not capable of enforcement during the marriage, divorce law recognizes the obligation and sometimes enforces the duty to support post-divorce in the form of alimony. Federal tax law recognizes this state-imposed obligation of support and taxes spousal support payments accordingly. For example, the Internal Revenue Service has long ruled that payments in satisfaction of a legal obligation of support do not constitute taxable gifts. In addition, the fact that the wife was owed a legal obligation of support during the marriage was a sufficient basis for not taxing her receipt of support as income after the marriage ended.

Under current tax law, when a marital unit breaks up at divorce, §§ 71 and 215 of the Internal Revenue Code are triggered. Under these provisions, payments of alimony are

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84. See, e.g., Lawhon v. Lawhon, 583 So. 2d 776 (Fla. App. 1991) (holding that support obligation required husband to pay wife's attorneys' fees in divorce and that obligation could not be waived).

85. The trend, however, in recent years is away from alimony. The Uniform Marital Dissolution Act states a preference for having post-divorce support obligations be satisfied out of property divisions. Most studies show that alimony awards are few (e.g., only ten percent of cases) and often are not enforced for more than one year. This shift has been criticized by a number of commentators who point out that husbands continue to have greater earning power, often enhanced by in-kind support from wives. The best way to prevent an unjust reward to husbands would be to continue sharing his earnings post-divorce in the form of alimony payments. See e.g., Herma Hill Kay, Equality and Difference: A Perspective on No-Fault Divorce and Its Aftermath, 56 U. CIN. L. REV. 1 (1987); Christopher D. Nelson, Note, Toward a Compensatory Model of Alimony in Alaska, 12 ALASKA L. REV. 101 (1995); Jane Rutherford, Duty in Divorce: Shared Income as a Path to Equality, 58 FORDHAM L. REV. 539 (1990).


either taxable to the recipient and deductible by the payor, or they are non-taxable transfers and non-deductible. The underlying principle is that the now-divided family will only be taxed once on the income that is used to support its prior members. This principle is consistent with the notion that the spousal unit is a single economic unit for federal tax purposes.88

There is not much direct law on the taxation of voluntary support transfers between spouses during a marriage. Presumably these payments are also controlled by the principle that income in the family unit should only be taxed once. But there are additional justifications. Voluntary support transfers occur between spouses during the marriage, often as the result of a decision to divide the labor of the family economic unit. In cases where there are two equal wage-earners, support transfers will be minimal. But where one spouse works in the market place and the other stays home, transfers occur in both directions. The earner provides goods for the unit that must be purchased in the marketplace and the stay-at-home spouse provides services. Whether these transfers result from informal bargaining or from the expectations of parties to a marriage, they are different from transfers that occur between unrelated persons in a commercial setting. These transfers are not income to the recipient, either because they are gifts, excluded from income under section 102 of the Internal Revenue Code, or they are simply fulfillment of legal and societal expectations of what spouses owe each other. Nor do these transfers constitute taxable gifts under the gift tax, either because they are exchanges of relatively equal value or because they are fulfilling a legal obligation of support.

2. The Problem

Differences in state law have not made major differences in the taxation of spousal support obligations, perhaps because states impose fairly similar requirements. And even where state law has differed, such as in Texas where there

88. See Deborah Geier, Simplifying and Rationalizing the Federal Income Tax Law Applicable to Transfers in Divorce, 55 TAX L. REV. 363, 369-71 (2002). This principle of taxing the family only once is also consistent with the Gould decision. See Gould, 245 U.S. at 153-54.
was no state-imposed alimony until 1995, the tax rules for support payments have been applied uniformly despite the state law differences.

Unmarried couples experience two problems regarding the taxation of support payments. One problem is uncertainty. The other is unequal treatment. For most unmarried couples, the law is simply not clear. For unmarried couples who are subject to a state-imposed obligation to support their partners, presumably such payments will be exempt from the gift tax. For other unmarried couples, the law is clear but unfair. Such payments do constitute taxable gifts, whether made during the relationship or post-dissolution.

Whether post-dissolution payments of support will be subject to income taxation in the hands of the recipient is an open question for all unmarried couples. The Internal Revenue Service has yet to rule on either the gift tax issue or the income tax issue. It has offered no public guidance, despite the fact that at least seven states impose support obligations on registered unmarried couples.

90. See, e.g., Hogg v. Comm'r, 13 T.C. 361 (1949) (holding that when a wife releases her right to support during the marriage in exchange for a promise of future post-divorce support from her husband, the payments arise because of the marital relationship and will be taxed the same as court-imposed alimony).
91. The policy justifications for subjecting such payments to the gift tax seem weak. Such payments are not the sort of "estate depleting" transfers that the gift tax was intended to reach. Nor do they result in an assignment of income, which has recently been suggested as an alternative justification for subjecting transfers of wealth to the gift tax. See Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. No. 107-16, 115 Stat. 38 (2001) (seeking to repeal the Estate Tax but keep the gift tax to discourage income shifting gift transfers). Since payments for support are payments for consumption they do not serve to shift income-producing property from one taxpayer to another.
92. It would also seem appropriate to exempt the receipt of such payments from the income tax either under the Gould rationale (which would be available only to partners subject to state-imposed support obligations) or on the theory that such payments spring from the intimate personal relationship that, at least at the formation, was founded on love and affection, or "detached and disinterested generosity." See Comm'r v. Duberstein, 363 U.S. 278 (1960) (holding that transfers that spring from love and affection or from detached and disinterested generosity are gifts under section 102 of the Code).
93. The states are Vermont, California, Connecticut, New Jersey, New Hampshire, Oregon, and Maine. When the new Washington statute becomes effective in June of 2008, it will become the 8th state to impose support
Finally, all unmarried couples\textsuperscript{94} who enter into dissolutions that require one partner to make support payments to the other will experience unequal tax treatment on those payments as compared with married couples. The ability to shift the tax burden on such payments under sections 71 and 215 of the Internal Revenue Code is only available for spouses. If these provisions were to be extended to unmarried couples, the question arises again as to which unmarried couples should be included. This question will be addressed in Part V.

### III. ALTERNATIVE FAMILIES AND STATE LAW

State recognition of alternative families has taken several different forms. Initially personal relationships were recognized in limited situations for limited purposes by judicial decisions. More recently, state statutes have been enacted to create state sanctioned statuses for certain unmarried couples who qualify. Some of these statuses are very similar to marriage. For the most part they are created as alternatives to marriage that are made available primarily to same-sex couples\textsuperscript{95} who have been excluded from marriage under other state laws.

#### A. Marvin v. Marvin

In 1976, the Supreme Court of California recognized the equitable rights of long term cohabitants when it issued its opinion in *Marvin v. Marvin*.\textsuperscript{96} Since that time legal professionals who work with separating cohabitants have relied on the *Marvin* case to argue that clients have a right to share in any wealth accumulated during the relationship, regardless of who has legal title to the wealth. *Marvin* is also cited as authority for post-separation support claims to the obligations on registered unmarried couples. See Wash. Rev. Code § 26.15.205 (as amended).

\textsuperscript{94} As well as same-sex married couples in Massachusetts due to DOMA.

\textsuperscript{95} Hawaii's Reciprocal Beneficiaries Act, HAW. REV. STAT. § 572C (2005), extends to couples other than same-sex intimate couples, and California's Registered Domestic Partnership Act, CAL. FAM. CODE §§ 297-299.6 (West 2005), extends to opposite sex couples over the age of 62, as does Washington's Domestic Partner Law, WASH. REV. CODE ANN. §§ 26.60.10-.70 (West 2007).

\textsuperscript{96} Marvin v. Marvin, 557 P.2d 106 (Cal. 1976).
extent such claims can be based on implied contract or *quantum meruit*.

Some legal scholars argued in the *Marvin* briefs that unmarried cohabitants should be treated similarly to married couples when they split up.\(^{97}\) Under this legal theory, any property acquired during the marriage would be divided in the same way that community property is divided upon divorce of a married couple. The California Supreme Court rejected this argument,\(^{98}\) but left room for unmarried couples to prove that they had privately contracted, either explicitly or implicitly, to have their relationship be treated the same as married couples. Upon proof of such a contract, an unmarried separating couple can be required by state law to divide property and pay spousal support in the same manner as divorcing married couples.

While opposite sex couples, such as the Marvins, might have trouble proving the existence of such a contract,\(^{99}\) same-sex couples often explicitly agree to just such an arrangement. And it is more likely that same-sex couples, as compared with opposite sex cohabitants, will admit at the time the relationship dissolves that they had such a contract whether explicit or implicit. This consequence is more likely because same sex couples cannot marry, yet they form relationships that mirror marriage. Often their expectations are that, if they separate, they will be subject to support and property division rules that are similar to those applied to divorcing couples.\(^{100}\)

\(^{97}\) Pre-*Marvin* cases in California had granted community property rights to putative spouses and similarly situated unmarried partners. For a discussion of *Marvin* and the pre-*Marvin* cases, see Herma Hill Kay & Carol Amyx, *Marvin v. Marvin: Preserving the Options*, 65 Cal. L. Rev. 937 (1977).

\(^{98}\) *Marvin*, 557 P.2d at 120 ("No language in the Family Law Act addresses the property rights of nonmarital partners, and nothing in the legislative history of the act suggests that the Legislature considered that subject. The delineation of the rights of nonmarital partners before 1970 had been fixed entirely by judicial decision; we see no reason to believe that the Legislature, by enacting the Family Law Act, intended to change that state of affairs.").

\(^{99}\) In fact, Michelle Marvin was unable to prove that she and Lee Marvin had an agreement to share assets and support each other. Thus she was not entitled to the rehabilitative alimony award that a trial court had awarded. *Marvin v. Marvin*, 176 Cal. Rptr. 555 (Cal Ct. App. 1981).

\(^{100}\) Gay and lesbian couples are likely to turn to mediation rather than courts when they dissolve their relationships out of fear that courts will not apply rules that acknowledge their relationships. For a discussion of gay and
Since 1976, most states have adopted the *Marvin* rule. Illinois is the primary exception. Some states require explicit contracts before co-habitant agreements will be enforceable as to property rights. Some states require that such contracts be in writing. The remaining states are willing to consider equitable claims by partners to property acquired during the relationship on the basis of implied agreements. Whether these equitable claims can amount to property rights that are sufficiently vested to be recognized as such under federal tax law remains an open question.

**B. Washington’s Meretricious Relationship Rule**

One state court has adopted the rule that some advocates had advanced in *Marvin*, namely that unmarried cohabitants be treated similarly to married couples. In *Marriage of Lindsey*, the Washington Supreme Court recognized the legal status of a heterosexual couple engaged in a

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101. See Hewitt v. Hewitt, 394 N.E.2d 1204 (Ill. 1979) (holding that it is against public policy to enforce cohabitant agreements because cohabitation is against public policy; marriage is the preferred relationship). No same-sex case has directly challenged Hewitt, although it is difficult to apply its public policy rationale (i.e., support of marriage) to a case involving a same-sex couple who cannot marry in any event. *But see* Scott v. Comm’r, 226 F.3d 871, 874-76 (7th Cir. 2000) (holding that survivor of lesbian relationship had not proved ownership of property acquired during relationship under resulting trust theory, and implicitly recognizing that unmarried couples may rely only on resulting trust theories rather than contract theories to assert shared ownership of property acquired during the relationship).


104. Reynolds v. Comm’r, 77 T.C.M (CCH) 1479 (1999) (holding that for unmarried opposite sex cohabitants, annual payments made pursuant to a settlement agreement were made in exchange for the taxpayer’s equitable rights in the property of her cohabitant, and as such, they were taxable only to the extent they exceeded her basis in the property). The court assumed that the cash payments did not exceed basis and thus there was not gain. The court acknowledged that it did not have full information about basis, but assumed that she acquired her interest in the property via gift and thus that basis was computed under §1015. In cases of appreciating property, however, a section 1015 basis would likely result in gain. I have been unable to find any other cases or rulings in which the tax consequences of property divisions between unmarried cohabitants is an issue.

meretricious relationship and declared that the state's community property laws would be applied upon the dissolution of the relationship in the same fashion as if the couple had been married. That judicial rule has been extended to same-sex couples. The rule has recently been extended to apply to a deceased couple, splitting the property acquired by one partner between the two of them at the moment of death, in the same way that community property would have been treated.

Given this extension of the rule to divide property at the moment of death between two deceased partners, even before any creditors can reach the assets of the titled partner, the equitable rights of the non-titled partner appear substantial. It is at least arguable that for estate tax purposes, such property should be treated the same as jointly owned or true community property, i.e., only half of the property should be included in the taxable estate of each partner.

C. Civil Unions, Marriage and Domestic Partnership

As of March 1, 2008, there are ten states that grant statewide recognition to same-sex unions. Massachusetts is the only state that recognizes same-sex marriage. Seven other states, California, Connecticut, New Hampshire, New Jersey, Oregon, Vermont, and Washington grant a broad array of rights and responsibilities to same-sex partners. In all of these states, other than New Hampshire and Washington (which have no state income tax), partners file state income taxes jointly. The same is true for same-sex married couples in Massachusetts.

Until recently, California was unique as the only community property state to have included unmarried Registered Domestic Partners (RDPs) in its community property regime. Washington became the second community property state to adopt community property rights for RDPs. Washington, however, has no state income tax. The community property regime in California creates distinctive

issues for California RDPs as they navigate the income tax reporting requirements at both the federal and the state level because the federal and state rules for reporting community income are different. For this reason, I will discuss the California situation separately below.

Finally, there are two additional states - Hawaii and Maine - that have adopted a special status for same sex couples. In Hawaii, the status is known as “reciprocal beneficiaries”\(^\text{110}\) and the rights extend primarily to property rights such as inheritance, including the right of a surviving partner to an elective share upon the death of the other partner. In Maine the relationships are called “domestic partnerships.” Under Maine law, domestic partners are jointly responsible for each other’s common welfare.\(^\text{112}\) They are given status as heirs of each other under the intestacy statutes, but are not given an elective share.\(^\text{112}\)

\section*{D. California’s Registered Domestic Partnership Law}

The California legislature passed the first state-wide registered domestic partner law in 1999.\(^\text{113}\) It extended only a handful of benefits to registered partners. A registry of such domestic partnerships has been maintained by the Secretary of State since 2000. Additional, but still minimal, benefits were extended to registered partners by subsequent legislative enactments in 2001.\(^\text{114}\)

On September 19, 2003, the Governor of the State of

\begin{footnotes}
\begin{enumerate}
\item Reciprocal Beneficiaries Act, HAW. REV. STAT. § 572C-1 (2005).
\item ME. REV. STAT. ANN. tit. 18-A § 1-201(10-A) (2008).
\item In every state except Georgia, there are probate statutes that prevent a spouse from disinherit the other spouse at death. These statutes generally give a spouse who has not been sufficiently provided for in the will of the deceased spouse the right to claim an “elective share” of the deceased’s estate. Elective share amounts range from one-quarter of the probate estate to one half of all property controlled by the decedent at death. See, e.g., UNIF. PROBATE CODE §§ 2-201-214 (amended 1993), 8 U.L.A. 101-32 (1998). Elective shares provide more protection for financially interdependent partners that do intestacy provisions.
\end{enumerate}
\end{footnotes}
California signed into law Assembly Bill 205 (AB 205), amending California Family Code (CFC) section 297.5. As amended, CFC section 297.5(a) reads as follows:

Registered domestic partners shall have the same rights, protections, and benefits, and shall be subject to the same responsibilities, obligations, and duties under law, whether they derive from statutes, administrative regulations, court rules, government policies, common law, or any other provisions or sources of law, as are granted to and imposed upon spouses.

This provision, by extending spousal rights and responsibilities, created a community property regime for registered domestic partners in California that is exactly the same as the community property regime for spouses. As a result of these statutory changes, the earned income of domestic partners qualifies as community income, as does income from all community assets. These changes became effective on January 1, 2005.

The community property regime makes California different from the other states that currently grant recognition to same-sex unions. California, like the other states that grant spousal-like status to same-sex couples, authorizes RDPs to file joint returns. Filing a joint return


116. It also extended the most significant benefits and burdens of marriage. Thus, for example, one cannot simply walk away from a partnership relationship but must obtain a court-supervised dissolution similar to divorce. Support obligations for partners and children can be awarded post-dissolution and agreements to alter state-created property rights must conform to the strict formalities required of spousal agreements.


118. The Washington statute, H.B. 3104, was signed by the Governor on March 12, 2008 and has an effective date of June 12, 2008 for most of its provisions. At that time, RDPs in Washington will begin enjoying community property rights.

119. The California rule is new, effective for tax year 2007. Joint returns for married same-sex couples are authorized in Massachusetts. Four other states authorize joint returns for partners in a civil union. They are New Jersey, Connecticut, Vermont, and Oregon. New Hampshire does not have a state incomes tax. Nor does Washington. A bill was introduced in Hawaii authorizing joint returns for reciprocal beneficiaries, but the state taxing authorities have asked for additional research on its effect since Hawaii, like these other states,
at the state level when the federal government requires the filing of a single return creates complexity for all same-sex partners who face this dilemma of different filing statuses. That is because state tax rules tend to follow federal tax rules. A taxpayer usually begins computation of state tax liability by using his or her adjusted gross income as computed on the federal tax form. States, in turn, verify reported income by cross-checking amounts reported to the federal government. For taxpayers with complicated returns, this different reporting status can create computational problems and add to the cost of filing taxes. To minimize the problem, married couples in Massachusetts are often advised to file at the state level as married filing separately, rather than married filing jointly. This option maintains the separate income and deduction items on each spouse's state return, which will be the same income and deductions reported on the federal return. That solution is not available for California RDPs. While they are free to file as married filing separately at the state level, they are not able to report their separate income and deductions from the federal returns. The community property rules require that California partners split all earned income equally between the two partners when reporting income for tax purposes. This is the traditional result, applying the rule of Poe v. Seaborn. The federal taxing authorities, however, have stated that the splitting of community personal service income will not be allowed at the federal level. As a result RDPs must complete their two federal returns filing as single taxpayers and they must complete a mock federal joint return to serve as the basis for their state return. In sum,


120. See CCA 200608038, discussed at pp 136-138, infra.

California taxpayers are at a unique disadvantage caused by the conflict between federal and state tax rules. The conflict has also created significant burdens on the state Franchise Tax Board.

E. The Problem for Partners: A Summary

Ten states now give state-wide recognition to same-sex partners who register under the relevant state statutes. Other states are considering creating alternative statuses. In some of these states, registered couples are required to file joint income tax returns. Furthermore, they are required to report taxable transactions on their state returns the way they would have reported them on the federal return if they had been married for federal tax purposes. For these partners, different tax rules apply to the same transaction, depending on whether they are filing federal or state returns. This clash between federal and state recognition of partners leads to confusion and an undue amount of complexity. In some cases, it is simply impossible to determine what the correct tax rule is at the federal level since there are no specific laws covering same-sex couples whose status is recognized at the state level. This uncertainty makes the federal law hard to administer on a uniform basis. Those


123. Consider for example a California RDP in which one partner sells a fifty percent interest in her home to her partner. Under federal tax law, if the sale produces a gain, she must report the gain to the extent it exceeds her $250,000 exemption. Her partner will have a cost basis in the purchased interest. At the state level, applying the federal rules that apply to spouses in such a situation, there is no gain or loss. The selling partner will report no gain on her state return and presumably still has $250,000 worth of exclusion that can be used on this home when she sells her other half interest. The purchasing partner will have lower carryover basis rather than cost basis and will have to maintain records of the two different basis amounts in order to compute gain when she ultimately sells her interest in the home. She will have a higher gain at the state level when she does sell because of the lower carryover basis.
taxpayers with advisors who are willing to make return decisions by analogizing to rules that have been applied to spouses in the past will take one position and those taxpayers with advisors who are unwilling to take advantageous positions for their clients without direct authority will take a different position.

IV. FEDERAL TAXATION AND STATE LAW

A. Summary of the Past

As discussed in Part II of this article, federal tax law has traditionally relied on state law to define property rights while federal tax law has determined how those property rights should be taxed. Since 1930, when the Supreme Court handed down its opinion in Poe v. Seaborn, state community property law has determined the allocation of income and deductions of the parties who make up the community.

This deference to state property law is not confined to community property regimes. In Morgan v. Commissioner, for example, state law was the basis for determining whether a power of appointment was a general power of appointment for purposes of federal estate taxation. Blair v. Commissioner applied Illinois trust law to determine the validity of an assignment of an interest in a trust, relying on the "bundle of rights" transferred under Illinois law to hold that the assignment was of a property interest and not merely an assignment of income. State property law has been used to determine whether interests exchanged qualified as like kind under section 1031 of the Internal Revenue Code.

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124. E.g., they might exclude post-dissolution support payments from the income of the recipient on the authority of the reasoning in Gould v. Gould, 245 U.S. 151 (1917).
125. E.g., they might report post-dissolution support payments as taxable income to the recipient because there is no specific exclusionary rule and section 61 purports to include such payments in income.
126. See United States v. Mitchell, 403 U.S. 190, 194-96 (1971) (holding that Louisiana spouse is taxed on fifty percent of husband's income despite the fact that she never benefited from the income).
129. Oregon Lumber Co. v. Comm'r, 20 T.C. 192, 197 (1953) (finding that the right to cut timber is personal under Oregon law and thus does not qualify for like-exchange under §1031); Comm'r v. Crichton, 122 F.2d 181, 181 (5th Cir. 1941), aff'd 42 B.T.A. 490 (1940) (applying Louisiana law to find that mineral
And the right of a co-owner of property to deduct one hundred percent of property taxes paid has been held to depend on whether state law assesses the tax against the entire property or the undivided interest held by the payor. These are just some of the examples in which state law has affected the calculation of federal tax liability.

Property ownership rules under state law also determine what property is available for the collection of delinquent taxes. Under section 6321, a tax lien can attach only to property that belongs to the delinquent taxpayer. While there has been some confusion about the role of state law in determining when the IRS can assert a valid tax lien, the correct understanding is that state property law determines ownership rights, which must be present for the lien to attach, whereas state debtor-creditor law does not apply. This means the IRS can reach ownership interests in homesteads, community property, tenancy by the entitites property, and spendthrift trusts even though state creditors cannot. But if the taxpayer does not own the property under state law, no federal lien can attach. As a result, state characterization rules that make property held in the non-taxpayer spouse's name community property would be reachable by the IRS for the tax debts of the

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130. See James v. Commissioner, 70 T.C.M. (CCH) 1420 (1995). Under Pennsylvania law property taxes on jointly owned property are assessed separately against each owner and so if one owner pays the tax in full he can only deduct his pro rata share. A different rule applies where the tax is assessed against the property as a whole and can be sold for payment thereby putting each owner at risk of loss for any nonpayment. See I.R.C. § 164 (2000).

131. I.R.C. § 6321 (2000) ("If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount ... shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.").

132. For a full explanation of this point see Steve R. Johnson, Why Craft Isn't Scary, 37 REAL PROP. PROB. & TR. J. 439 (2002).

133. See United States v. Rodgers, 461 U.S. 677 (1983) (involving Texas homestead law which would have prevented a forced sale of the home by state creditors).

134. United States v. Overman, 424 F.2d. 1142 (9th Cir. 1970) (Washington community property could be reached by IRS for pre-marital debt even though under state law it would have been protected from creditors holding such debts).


136. See Bank One Ohio Trust v. United States, 80 F.3d 173 (6th Cir. 1996).
B. A Break from the Past

Despite a long tradition of looking to state law to determine family relationships and ownership of property rights, federal tax law has taken a new course of action in response to state-recognition of same-sex unions. Two examples of this new direction are (1) Congressional enactment of the Defense of Marriage Act, and (2) the refusal by the Internal Revenue Service to follow the rule of Poe v. Seaborn with respect to the community property of California RDPs.

1. The Defense of Marriage Act (DOMA)

The federal part of the Defense of Marriage Act states:

In determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word "marriage" means only a legal union between one man and one woman as husband and wife, and the word "spouse" refers only to a person of the opposite sex who is a husband or a wife. 138

a. Application of DOMA to Federal Tax Law

The plain meaning of DOMA is that for federal tax purposes, same-sex spouses will be excluded from all tax rules that apply to spouses. Thus, Massachusetts same-sex spouses cannot file joint returns, whether such filing would create a marriage penalty or bonus and they cannot rely on section 1041 to determine the tax consequences of inter-spousal transfers. Sections 71 and 215 will not apply to post-divorce alimony. Transfers at death will be subject to the estate tax without application of the marital deduction.

In addition, a host of anti-abuse rules applicable to spouses will not apply to Massachusetts same-sex spouses. Thus, such spouses could create artificial tax losses by selling loss property to each other. Sections 267 and 1041 would prevent the recognition of such losses for sales between

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opposite-sex spouses. Another possibility for same-sex spouses would be for one spouse to sell greatly appreciated property to the other spouse on the installment method, with the payment of the note delayed for many years. No gain would be recognized until the installment note is paid. The purchasing spouse would receive the benefit of cost basis equal to the property’s current fair market value and could turn around and sell the property on the open market at its current value for no tax gain. As a result, the couple would have the cash and no tax bill. This arrangement would not be possible for opposite-sex spouses because section 1041(b) would prevent the purchasing spouse from receiving a step-up in basis and thus the sale to a third party would produce a taxable gain.139

The same-sex couple would also avoid certain marriage tax penalties. If both spouses are employed and earn roughly equal income, then they will pay fewer income taxes by being able to file as single taxpayers rather than married ones. If one or both spouses receive social security benefits as well as other income, then the taxable amounts under section 86 will be lower for the same-sex spouses than for opposite-sex spouses.140 The limitation on mortgage interest deductions also creates a penalty for spouses. Two single taxpayers (or two same-sex spouses) can claim interest deductions on debt of $2.2 million secured by four different homes, whereas spouses would be limited to debt of $1.1 million and no more than two homes.141

It is not clear whether DOMA would impact all federal tax rules regarding payment of spousal support obligations. DOMA would apply to deny same-sex spouses the benefit of statutes and rulings and regulations which by their terms

139. In addition, section 453(e) would deny the benefit of this abuse transaction to other close family members because the sale for cash by the second family member would trigger immediate gain to the first family member.

140. The base amount, above which social security benefits may be subject to taxation, is $25,000 for each same-sex spouse and $32,000 for a married couple filing jointly. The base amount is adjusted gross income plus fifty percent of social security benefits. Thus, for example, if spouse A and B each have $24,000 in social security benefits and $13,000 in other income, and if they were taxed as single, neither would exceed the $25,000 base amount and no social security benefits would be taxed. But, if they were taxed as married (filing jointly), then they exceed the base amount by $18,000 and a portion of their social security benefits will be taxed.

apply to spouses. Thus, for example, it is clear that sections 71 and 215 cannot apply to payments of alimony by divorcing same-sex spouses, because those statutes apply only to "spouses." The law that has developed around state-imposed obligations of support, however, is not restricted to spouses. Support obligations are also imposed to require parents to support their minor children. Payment of support to a minor child is not a taxable gift and it is not taxable income to the child. The argument that support payments are not taxable gifts under IRS rulings or taxable income under Gould does not have to rely on spousal status, but only on the validity of the state-imposed obligation. Thus, DOMA should have no effect on these tax rules.

It has been suggested by some that the IRS might rely on DOMA to deny the reality of state imposed support obligations and property rights to partners in civil unions and domestic partnerships. DOMA's potential application to tax rules regarding spousal support has already been addressed. For the same reasons, DOMA should not affect the tax treatment of state-required support payments between non-spousal partners. A similar argument applies to property rights. Federal tax law recognizes state property law generally, whether the property is marital property or another form of jointly owned property.

But there is another reason DOMA should not apply to civil unions and domestic partnerships. Partners in civil unions and domestic partnerships are not married; they are not spouses. Thus, DOMA does not apply to them. Under a plain meaning construction, DOMA only disregards the state-created marital status of same-sex partners; it does not say that federal law will disregard other state-created rights of same-sex partners.


143. See Knight v. Superior Court, 26 Cal. Rptr. 3d 687 (Cal Ct. App. 2005) (holding that registered domestic partners are not spouses); Smelt v. County of Orange, 447 F.3d 673 (9th Cir. 2006) (holding that registered domestic partners do not have standing to challenge DOMA because, in part, they are not spouses); see also I.R.S. Priv. Ltr. Rul. 200524016 (June 17, 2005) and I.R.S. Priv. Ltr. Rul. 200524017 (June 17, 2005) (both of which appear to conclude that California Registered Domestic Partners are not spouses under DOMA).
b. Critique of DOMA's Application to Federal Tax Law

While the federal government clearly has the power to define spouse for federal tax purposes, it has never done so before. The fact that it has chosen to do so in this one instance, without giving much scrutiny to the consequences, is suspect. The alleged purpose of DOMA is to advance four governmental interests: (1) defending and nurturing the institution of traditional, heterosexual marriage; (2) defending traditional notions of morality; (3) protecting state sovereignty and democratic self-governance; and (4) preserving scarce government resources.144

There are strong arguments that none of these four interests is sufficiently furthered by the tax law's nonrecognition of same-sex marriages. First of all, the third interest, protecting state sovereignty, seems irrelevant to the federal portion of DOMA under which the federal rule trumps state rules. This interest is presumably intended as a justification for the other provision in DOMA, that states will not be required under full faith and credit to honor same-sex marriages from other states.

The second interest, defending morality, is, after the Supreme Court decision in Romer v. Evans,145 questionable. In Romer, the Court said: "Moral disapproval of a group cannot be a legitimate governmental interest under the Equal Protection Clause because legal classifications must not be "drawn for the purpose of disadvantaging the group burdened by the law."146

Finally, it is not clear how the exclusion of same-sex spouses is rationally related to accomplishing goal one, defending heterosexual marriage, or goal four, protecting scarce government resources. If marriage created only tax benefits, one might see a nexus between limiting the beneficial rules to heterosexual couples and defending their marriages. However, as this article has tried to show, the tax law has become attuned to the financial interdependencies of married couples over time and has developed special rules

146. Id. at 633; see also Lawrence v. Texas, 539 U.S. 558, 582-83 (2003) (O'Connor, J., concurring).
that attempt to tax them correctly, but not necessarily by giving them benefits. Indeed, often the special tax rules for spouses create burdens. It could turn out that taxing same-sex spouses as married couples under the current joint return rules would produce more, rather than less, tax revenue. In other words, DOMA may actually serve to reduce scarce government resources.

2. Chief Counsel Advice 200608038

The IRS issued this Chief Counsel Advice memorandum (CCA) in early 2006 to announce that the Seaborn income splitting rule would not be applied to California RDPs. The rationale offered was that the rule had never been applied to anyone other than spouses. This rationale is merely descriptive. It does not provide a reasoned justification for different treatment of RDPs.

a. Effect of CCA 200608038

Read narrowly, the CCA only addresses the taxation of community income that is earned by one of the partners. That is, it says nothing about passive income such as rents or dividends on community property. Nor does it address any of the other issues in which community property characterization is crucial in determining tax consequences. Questions abound, such as whether creation of community property is a taxable event, whether or not community property ownership will be honored by the IRS when the property is ultimately divided at dissolution or death, and whether payments out of community property bank accounts for deductible items will be viewed as paid by both partners or just by the partner whose earnings funded the account.

The answers to all of these community property tax questions are provided for spouses in a fourteen page IRS

147. See, e.g., Seto, supra note 82 (describing all of the ways that same sex spouses, by escaping taxation as spouses, can actually benefit from the tax law or manipulate its rules to their advantage).

148. It is very difficult to measure marriage bonuses and penalties accurately. One study, based on the 1999 tax year found that of the 51.4 million joint returns filed that year, forty-eight percent experienced a marriage penalty and forty-one percent experienced a bonus. The aggregate net penalty was $1.6 billion. See Nicholas Bull et al., Defining and Measuring Marriage Penalties and Bonuses, OTA Paper 82-Revised, (Nov. 1999) available at http://www.ustreas.gov/offices/tax-policy/library/ota82_revised.pdf.
In May of 2007, the Service edited this publication by adding the following language in a prominent place on page two:

**California domestic partners.** If you are a registered domestic partner in California, the rules discussed in this publication for reporting community income do not apply to you. You must report all wages, salaries, and other compensation received for your personal services on your own return.

This publication addresses the reporting of income from property as well as from wages, gains and losses on the disposition of property, income from partnerships, the allocation of deductions, and many other questions that might arise for taxpayers who are subject to a community property regime. The excerpt above is the only reference to RDPs. By negative implication one might conclude that all of the rules in Publication 555 do apply to RDPs, other than the income splitting rule for personal service compensation.

### b. Critique

In *Poe v. Seaborn*, the Supreme Court held that income should be taxed to the person who owns the income. *Seaborn*’s authority has not been seriously questioned, either by the Service or by the courts for more than seventy-five years. Recent cases have focused on whether the income-splitting rule should be available to spouses from certain foreign countries with community property regimes.\(^{150}\) And, as recently as 1987, the Service ruled that Wisconsin’s marital property regime was subject to the income splitting rules of *Seaborn*.\(^{151}\)

Under California state law, community income, including income from wages and salaries, is owned equally by the two spouses or the two RDPs. The CCA brushes this holding aside by claiming that income splitting has never been applied to anyone other than spouses. That is true only

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150. Westerdahl v. Comm’r, 82 T.C. 83 (1984) (spouse from Sweden, income splitting allowed); Angerhofer v. Comm’r, 87 T.C. 814 (1986) (spouse from Germany, wife was not sufficiently vested in community earnings of husband under German law to allow income splitting under *Seaborn*).

because no state has ever vested ownership rights to earned income in unmarried partners before. But now California has done that and the California law is not a sham like the law of Oklahoma which gave spouses the right to opt into the community property regime. In 1944, the Supreme Court held that the Oklahoma law was insufficient to vest spouses with ownership rights that allowed them to split income under Seaborn.\(^{152}\) The CCA relies on this Oklahoma case to deny income splitting to RDPs, pointing out that the Court there concluded: "The important fact is that the community system of Oklahoma is not a system, dictated by State policy, as an incident of matrimony."\(^{153}\) The importance of this language is not that property systems must be an incident of matrimony to be recognized, but that they must be part of a system dictated by the state. Spouses in Oklahoma could opt into the community property system if they wanted to, but those that did not opt in remained married and enjoyed all other benefits of marriage. Under California law, RDPs are mandatorily subject to the community property regime.\(^{154}\) For them, community property is part of a single system and not an option they can elect or reject while retaining the rest of the rights and obligations in the system.

While I believe the CCA is wrong-headed,\(^{155}\) there may, however, be a possible justification for treating RDPs different from spouses with respect to earned income. Spouses file as married taxpayers using the joint or married filing separate rate structures. RDPs, who are not spouses, file as single taxpayers. Since most spouses file jointly, the splitting of earned income is irrelevant to their tax liability. Those who file as married filing separately will split their income, but will be subjected to the higher tax brackets for

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\(^{152}\) Comm'r v. Harmon, 323 U.S. 44 (1944).


\(^{154}\) Spouses and partners can transmute community property into separate property in California, but to do so they must follow the specific rules that are part of the state's community property system. Thus they are not able to elect out of the system as Oklahoma spouses could do.

\(^{155}\) For additional arguments critiquing the CCA, see Patricia A. Cain, Relitigating Seaborn, Taxing the Community Income of California Registered Domestic Partners, 111 TAX NOTES 561 (2006); and Dennis J. Ventry Jr., No Income Splitting for Domestic Partners: How the IRS Erred, 110 TAX NOTES 1221 (2006).
that filing status. Yet for RDPs, who must file under the lower single taxpayer rates, at the federal level, the ability to split would, in the case of partners with very disproportionate incomes, normally create a tax benefit.

This possible justification might be a sufficient basis for Congress to enact a special rule for RDPs, comparable to the rule under section 879, applicable to couples that include a non-resident alien spouse. In such cases the earned community income is attributed to the spouse who earns it. This special legislative rule is necessary to reverse the Seaborn rule that all community income is taxed to the members of the community because they are the “owners” of the income. But the reversal of Seaborn should come from Congress, not from the IRS.

There are other problems with the CCA. It is silent as to any tax issue other than who reports the earned community income. Tax return preparers, family lawyers, and estate planners all appear to have a wide variety of opinions about how to interpret this CCA. At its narrowest, it can be interpreted to mean that partners must report their own earned income even though it is community income, but all other consequences of Poe v. Seaborn still apply. At its broadest, it can be interpreted to mean that the IRS will not recognize the community property rights of California RDPs, and thus none of the consequences of Poe v. Seaborn would apply to RDPs. While I think there is no basis for interpreting the CCA broadly, the IRS has been extremely unhelpful in clarifying its position. So far it has issued no public ruling, and it has refused to answer questions raised in a private letter ruling request.156

The failure of the IRS to address the community property question for RDPs is not only inconsistent with its treatment of community property spouses, but it also creates an unacceptable level of uncertainty for RDP taxpayers. This uncertainty creates further costs for RDPs as they try to comply with the federal tax law.

V. THE NEED FOR A FEDERAL SOLUTION

This article has identified a number of different problems that the current tax law creates for same-sex couples,
whether their relationships are recognized under state law or not. Current law, if applied accurately to reflect the differences among state laws, would result in a lack of uniformity reminiscent of the time before enactment of the Revenue Act of 1948. This lack of uniformity is particularly clear now that California and Washington have extended community property rights to Registered Domestic Partners. But, putting aside the special problems created by community property, the failure of the federal government to provide reasonable guidance to all same-sex partners who must file tax returns in the face of uncertain rules is in total conflict with principles of good tax administration. The current administration appears committed to remaining silent about the tax treatment of same-sex couples, perhaps out of fear that any pronouncement might seem to support such relationships.  

Applying current law, however, would not be adequate even under the most positive interpretations of existing rules. While it would be possible, for example, to apply pre-section 1041 law to community property divisions upon dissolutions for RDPs, it is not clear that same-sex couples in other states would receive the same benefit since their rights in marital property are not necessarily vested fifty-fifty. And while recognition of state-imposed obligations of support would prevent the levy of a gift tax on support transfers in those states where such obligations are imposed, the determination of what constitutes support during an ongoing relationship is an indeterminate and messy endeavor.

DOMA is another consideration. Massachusetts same-sex spouses could currently enjoy the certainty of the tax rules that are applied to spouses generally were it not for DOMA. And Treasury and the IRS are not free to apply specific spousal tax rules to same-sex partners by analogy so long as DOMA is on the books.

Thus, the only satisfactory solution is a federal legislative one. The legislative response could take several forms, but, in its ideal state, it would repeal at least the federal portion of

157. I, along with other lawyers, have asked the IRS to issue rulings, public and private, to provide answers to a number of the tax questions prompted by RDP community property ownership in California. No rulings have been issued and the only public statement by the IRS is restricted to the tax treatment of personal service income. See Cain, supra note 151.
DOMA.

The best way to create broad reform would be to adopt one uniform set of rules that would apply to all financially interdependent couples, whether married or not, and whether recognized as couples by state law or not. While that is my preferred approach, and the one I will address at the end of this section, narrower alternatives are also worth considering.

A. The Section by Section Approach

Nancy Polikoff has suggested that the right way to determine whether particular statutes should be applied to spouses or other types of family arrangements would be to determine the purpose of the statutory provision and then scrutinize the classification. For example, if the elective share in probate codes is justified to prevent the disininheritance of dependent spouses, then dependency ought to be the determinative factor for application of the section, rather than marriage. Or, if the purpose of a statute is to address the needs of children, then a classification based on parenthood would be more appropriate than one based on marriage.\(^\text{159}\)

A similar approach could be used to analyze each tax statute that makes a distinction based on marital status. While it would take an inordinate amount of time to review all such statutes, some key ones come to mind and suggest immediate Congressional review. For example, sections 105, 106, and 125 of the Internal Revenue Code encourage employers to provide health care coverage to their employees and the employee's family members by exempting the benefit of coverage from income taxation. Sections 105 and 125 explicitly grant this tax exemption to benefits that run to the employee, the employee's spouse, and the employee's dependents. But in the early 1990s, employers began to understand that some of their unmarried employees deserved similar coverage for their partners. We now have thousands of such employer health plans throughout the country that offer domestic partner benefits. The purpose of the tax exclusion is to encourage the provision of health plans that

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159. See Nancy D. Polikoff, Beyond (Straight and Gay) Marriage: Valuing All Families under the Law 126 (Beacon Press 2008).
will ultimately cover more and more Americans. I can think of no policy justification for making the tax benefit of such plans dependent on marriage. To do so merely frustrates the primary purpose of extending coverage. Taxing the benefit may discourage the inclusion of domestic partners. But, more tellingly, treating plan beneficiaries differently imposes costs on employers who might, as a result, have second thoughts about offering such plans. These provisions of the Internal Revenue Code should be amended to exempt from income all employer-provided health care benefits, including those to domestic partners.\textsuperscript{160}

Another rule that deserves early review under a section-by-section approach is the rule that subjects support payments to non-dependents to the gift tax. The purpose of the gift tax used to be to back up the estate tax. To the extent that is still the purpose, payments for support result in immediate consumption and are not the sort of wealth transfers that the estate tax is designed to cover. With the recent changes to the estate and gift tax, especially with the increase of the estate tax exemption and the decoupling of that exemption from the gift tax, the purpose of the gift tax has shifted. Now the justification for a lower gift tax exemption is that its purpose is to protect the progressivity of the income tax rates. In other words, gifts can shift income to lower bracket taxpayers. Thus, the argument goes, we need to retain a gift tax to discourage such transfers. But payments to support another person are not shifting income because there is no income-producing wealth transfer. In view of the purpose of the gift tax, it makes little sense to have a rule that exempts support payments to spouses but not support payments to ageing parents, domestic partners, or adult children who come upon hard times. This is a rule where the bright line of marriage certainly needs to be reconsidered.\textsuperscript{161}

\textsuperscript{160} Such a bill has been introduced. Tax Equity for Domestic Partner and Health Plan Beneficiaries Act, S. 1556, 110th Cong. (2007).
\textsuperscript{161} For a more detailed development of this argument, see Patricia A. Cain, \textit{Same-Sex Couples and the Federal Tax Laws}, 1 Law & Sexuality 97, 125 (1991).
B. Adopt Spousal Treatment for Couples in State-Recognized Relationships

Another possible solution for same-sex couples would be to extend spousal treatment to those couples whose relationships are recognized under state law. The primary argument for this solution is that the property sharing rules and the support obligations that are imposed by state law on same-sex domestic partnerships and civil unions are a justificatory basis for treating them the same as spouses under the federal tax law. Such rules are indications that the couples are operating as a single economic unit and should be taxed as such. Arguments against this solution include the following:

1. This solution leads to the same lack of unity that federal tax law experienced when it recognized community property regimes for tax purposes. Uniform treatment of all taxpayers, no matter what state they reside in, is a desirable goal.

2. It is not always clear which attributes of marriage are the most important for determining whether a couple should be taxed as a single economic unit. Hawaii, for example, appears to impose claims to property, but not necessarily claims to support. And even in those states where support obligations are imposed, it is very difficult to determine the meaning of those obligations. Tax law considers support to include payments well beyond the old common law doctrine of necessities. Should any obligation of support justify single economic treatment for tax purposes or would the federal taxing authorities need to investigate the nature of the support obligation in each state? This sort of state-by-state determination of spousal equivalency would also place a burden on the Internal Revenue Service.

C. A Uniform and Equitable Solution

The only way to attain true uniformity across state lines and to provide equitable tax treatment for all families would be for the tax law to do something totally new: ignore state marital property law and instead create a federal definition of domestic partnership for tax purposes. The federal definition
could create uniform rules regarding allocation of income and deductions or it could allow partners to create their own allocations. Whatever rules were adopted, they would have to be enforced consistently during the relation, upon dissolution and at death. That is, they would need economic substance.\(^{162}\) And to erase the marriage tax penalty, they would have to be applied equally to spouses as well as domestic partners.

Tax rules akin to existing rules applied to spouses should apply to the formation and dissolution of such partnerships. That is, there should be no tax consequences at either point in time. The partnership should be viewed as a single entity. When wealth is transferred in or out of the entity, the tax consequences (e.g., gain, loss, deduction) should affect the entity and not the individuals. In effect, the domestic partnership would be taxed in a manner similar to business partnerships, with tax consequences computed at the entity level and the net gain or loss distributed out to the two partners for them to report on their own tax returns. Each couple would file an information return similar to the Form 1065 that partnerships file. All income and all deductions could be aggregated and reported on the information return. This would relieve partners from determining whose income is whose and who paid which deduction, a benefit that the current joint return provides for married couples. Once taxable income has been calculated, it should be allocated between the two partners, either fifty-fifty or in accordance with their own alternative allocation.

Under this scheme, each partner or spouse could then file an individual tax return and everyone would use the same rate schedule to compute the tax owed. Marriage would no longer create penalties or bonuses. All couples who wished to form a tax partnership could do so. Couples who did not wish to form such partnerships would report their own income and deductions as single taxpayers do now. The federal tax partnership rules would provide the sole route for splitting income and deductions. Spouses or partners who elected to file individual returns outside the tax partnership regime

\(^{162}\) The economic substance doctrine has long been part of the “common law” of taxation. See Joseph Bankman, *The Economic Substance Doctrine*, 74 S. CAL. L. REV. 5 (2000). In partnership tax, there is statutory recognition of special allocations of gain and loss, but only if the allocation has “substantial economic effect.” I.R.C. § 704(b) (2000).
would report their own earnings and their share of income from property based on state rules of ownership.

While partners should be allowed to split earned income in any way they want, the presumption should be fifty-fifty. Taxation would follow the ownership of the income under the agreement. Income from property would be split in accord with the allocated ownership interest in the income-producing property. Income that is not consumed would have to remain in the partnership for future consumption or for distribution at the termination of the relationship by death or divorce.

This solution not only erases the difference in tax treatment between spouses and partners that derive from application of different state laws, but also erases the difference in treatment between spouses and all unmarried couples. State property law would be important only in determining property ownership rights of couples who elected to file outside of the partnership regime. Legal obligations of support could remain relevant, although my own preference would be to exempt all payments of support from the gift tax.

State law, however, would need to enforce the tax partnership agreements at dissolution of the partnership, whether by “divorce” or at death. Property divisions at these two points in time have always been a core concern of state law, typically domestic relations law. Principles of federalism militate against a federal tax scheme that would impose property distribution rules upon states that are in conflict with state law. It may even be unconstitutional for the federal government to intervene in such matters, either because these matters are not within the limited powers of the federal government or because such intervention would

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163. There need not be a separate partnership account as such, but the spouses would have to retain some record to support a claim of property ownership that is not fifty-fifty. Unconsumed income converted into savings would be represented in assets owned by the couple, holding title in whatever manner they wished. But if the property is ever distributed to one partner or spouse, it would have to be done in accord with the underlying “capital accounts” in the partnership and if there were insufficient proof of unequal accounts, then the accounts would be presumed fifty-fifty.

164. Absent effective enforcement, the terms of the agreements would have no economic substance.

violate the Tenth Amendment by commandeering the states' governments to conform to the federal rules.\(^{166}\)

Since the decision in *Marvin v. Marvin*, however, all states, other than Illinois, have been willing to enforce contracts between unmarried cohabiting couples. Thus, for unmarried couples outside of Illinois, agreements to share income and property should be fully enforceable under state law. Agreements between spouses, on the other hand, present another problem at least to the extent such agreements are intended to change the state's domestic relations laws. At common law, postnuptial agreements between spouses regarding their property rights were generally void. While that rule is changing, states continue to apply close scrutiny to such contracts and sometimes hold them void as against public policy, as lacking in consideration, or as unconscionable.\(^{167}\)

The details of the development of this federal definition of domestic partnership are for another project.\(^{168}\) Here, the point is to suggest the possibility of such an arrangement and to show that a federal definition of domestic partner would remove many of the perceived problems caused by a tax system that over-relied on marriage. The most important aspects of such a federal solution are that it would ensure uniformity among states and, as supreme federal law, would provide an accurate reporting status even for same sex couples living in states where civil unions and domestic

\(^{166}\) See *Marvin v. Marvin*, 136 S.W.3d 595 (Tenn. 2004)(holding postnuptial agreement void for lack of consideration and discussing history of judicial reluctance to enforce such agreements).

\(^{167}\) The definition would need to be narrower than the ALI definition that is suggested for property divisions between unmarried cohabitants. See Mark Strasser, *A Small Step Forward: The ALI Domestic Partners Recommendation*, 2001 BYU L. REV. 1135 (2001), for a description of these proposals. Lawrence Waggoner has proposed a definition for "committed partners" to be treated as intestate heirs under the Uniform Probate Code. Partners must share a common household and have a marriage-like relationship as established by meeting a list of factors. The federal definition may not need to list such factors because it would in effect create the sharing of financial resources and property by virtue of recognizing the reality of the partnership agreement that is the basis for the tax return. But see Jennifer A. Drobac and Antony Page, *A Uniform Domestic Partnership Act: Marrying Business Partnership and Family Law*, 41 Ga. L. REV. 349 (2007), describing a proposal much like the one I'm suggesting, but intended to be adopted at the state level.
partnerships are not possible. It would also end the marriage tax penalty. The goal of such a scheme is to tax all families fairly.

169. Many states have statutes that ban recognition of same-sex marriages. But an increasing number of states have added prohibitions on recognition of same-sex civil unions or partnerships of any kind. ARK. CONST. amend. 83, § 2 (2004) ("Legal status for unmarried persons which is identical or substantially similar to marital status shall not be valid or recognized in Arkansas."); GA. CONST. art. 1, § 4, para. I (2004) ("No union between persons of the same sex shall be recognized by this state as entitled to the benefits of marriage."); TEX. FAM. CODE ANN. § 6.204 (Vernon Supp. 2003) ("A marriage between persons of the same sex or a civil union is contrary to the public policy of this state and is void in this state."); VA. CODE ANN. § 20-45.3 (2004) ("A civil union, partnership contract, or other arrangement between persons of the same sex purporting to bestow the privileges or obligations of marriage is prohibited.").