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The Unintended Tax Advantages of Gay Marriage

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Abstract

The Internal Revenue Code (the Code) contains numerous special rules applicable to the income taxation of persons related by marriage, birth, adoption, or ownership. This Article suggests a new approach to their analysis. Many basic tax rules assume that taxpayers are self-interested and unaffiliated. Where this assumption is incorrect, the Code makes adjustments to its otherwise applicable rules. Most of the resulting related-party anti-avoidance rules apply only in the context of specified formal relationships—marriage, parent/child, or owner/business.

The Article tests this thesis by comparing the income tax treatment of heterosexual married couples with that of gay couples in committed long-term relationships. Gay couples are not married for tax purposes, nor are they spouses within the meaning of the Code. Gay marriage therefore never by itself invokes any related-party rules. The Article explores a series of tax-avoidance problems in the contexts of marriage and extended families. None of the relevant anti-abuse rules apply to gay spouses. As a result, gay couples should be able to arrange their affairs so as to pay federal income tax at significantly lower effective rates, on average, than identically situated heterosexual married couples.

The Article concludes that the only way to ensure that gay couples will be taxed no more favorably than heterosexual married couples is to list gay marriage as one of the proxy relationships that automatically invokes pertinent anti-abuse rules—in other words, to treat gay marriage as marriage for federal income tax purposes. In the absence of an attractive formal status that then invokes related-party anti-abuse rules, well-advised gay couples are, and will continue to be, permitted to pay systematically lower federal income taxes than heterosexual married couples—a result unlikely to be acceptable to a majority of Americans in the long run.

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I. Introduction

"[Tax is] a field beset with invisible boomerangs."[1]

The Internal Revenue Code (the "Code") contains some 250 special rules applicable to the income taxation of spouses, parents, children, or closely-held businesses and other persons related by marriage, birth, adoption, or ownership.[2] The average taxpayer is most likely to encounter the rules that

1. Arrowsmith v. Comm'r, 344 U.S. 6, 12 (1965) (Jackson, J., dissenting).

2. *See* I.R.C. § 1 (2002 & West Supp. 2008) (dealing with rates imposed based on family status); *id.* § 2 (dealing with family status definitions); *id.* § 21 (dealing with dependent care credit); *id.* § 22 (dealing with credit for elderly and disabled); *id.* § 23 (dealing with adoption expenses); *id.* § 24 (dealing with child tax credit); *id.* § 25 (dealing with home mortgage credit); *id.* § 25A (dealing with Hope and Lifetime Learning credits); *id.* § 25B (dealing with qualified retirement savings contributions); *id.* § 32 (dealing with Earned Income credit); *id.* § 35 (dealing with credit for health insurance costs); *id.* § 38 (dealing with general business credit); *id.* § 41 (dealing with research credit); *id.* § 42 (dealing with low-income housing credit); *id.* § 45 (dealing with renewable source electricity credit); *id.* § 45A (dealing with Indian employment credit); *id.* § 45D (dealing with new markets tax credit); *id.* § 45K (dealing with unconventional fuels credit); *id.* § 49 (dealing with at-risk rules); *id.* § 50 (dealing with investment credit special rules); *id.* § 55 (dealing with alternative minimum tax); *id.* § 56 (dealing with AMT adjustments); *id.* § 59(j) (dealing with unearned income of minor children); *id.* § 62 (defining adjusted gross income); *id.* § 63 (defining taxable income); *id.* § 66 (dealing with community income of estranged spouses); *id.* § 68 (dealing with overall limitation on itemized deductions); § 71 (dealing with alimony); *id.* § 72 (dealing with annuities); *id.* § 73 (dealing with services of children); *id.* § 86 (dealing with Social Security benefits); *id.* § 101 (dealing with death benefits); *id.* § 105 (dealing with accident and health insurance benefits); *id.* § 106 (dealing with employer-paid health insurance); *id.* § 108 (dealing with debt discharge income); *id.* § 119 (dealing with employer-provided meals and lodging); *id.* § 120 (dealing with group legal services plans); *id.* § 121 (dealing with sale of principal residence); *id.* § 125 (dealing with cafeteria plans); *id.* § 127 (dealing with educational assistance programs); *id.* § 129 (dealing with dependent care assistance programs); *id.* § 132 (dealing with fringe benefits); *id.* § 135 (dealing with U.S. savings bonds); *id.* § 138 (dealing with Medical Advantage medical savings accounts); *id.* § 142 (dealing with exempt facility bonds); *id.* § 144 (dealing with qualified small issue bonds); *id.* § 147 (dealing with private activity bonds); *id.* § 151 (dealing with personal exemptions); *id.* § 152 (defining "dependent"); *id.* § 162 (dealing with trade or business expenses); *id.* § 163 (dealing with interest); *id.* § 165 (dealing with losses); *id.* § 167 (dealing with depreciation); *id.* § 168 (dealing with accelerated cost recovery system); *id.* § 170 (dealing with charitable contributions); *id.* § 172 (dealing with net operating loss carryovers); *id.* § 179 (dealing with elective expensing); *id.* § 179A (dealing with clean-fuel vehicles); *id.* § 194 (dealing with reforestation expenses); *id.* § 197 (dealing with amortization of intangibles); *id.*

§ 199 (dealing with income attributable to domestic production activities); *id.* § 213 (dealing with medical expenses); *id.* § 215 (dealing with alimony deduction); *id.* § 217 (dealing with moving expenses); *id.* § 219 (dealing with retirement savings); *id.* § 220 (dealing with Archer medical savings accounts); *id.* § 221 (dealing with education loans); *id.* § 222 (dealing with qualified tuition); *id.* § 223 (dealing with health savings accounts); *id.* § 263A (dealing with capitalization); *id.* § 264 (dealing with nondeductibility of life insurance premiums); *id.* § 267 (dealing with transactions between related taxpayers); *id.* § 269A (dealing with personal service corporations); *id.* § 269B (dealing with stapled entities); *id.* § 274 (dealing with entertainment expenses); *id.* § 280A (dealing with business use or rental of home); *id.* § 280F (dealing with limitations on depreciation); *id.* § 302 (dealing with distributions in redemption of stock); *id.* § 303 (dealing with distributions in redemption of stock to pay death taxes); *id.* § 304 (dealing with redemption through related corporations); *id.* § 306 (dealing with dispositions of section 306 stock); *id.* § 318 (dealing with constructive ownership of stock); *id.* § 336 (dealing with property distributed in complete liquidation); *id.* § 338 (dealing with stock purchases treated as asset acquisitions); *id.* § 351 (dealing with transfer to controlled corporation); *id.* § 354 (dealing with nonrecognition in reorganizations); *id.* § 355 (dealing with distribution of controlled corporation stock); *id.* § 356 (dealing with receipt of additional consideration in corporate reorganizations); *id.* § 367 (dealing with reorganizations involving foreign corporations); *id.* § 382 (dealing with limitation on net operating losses after ownership change); *id.* § 401 (dealing with pension plans); *id.* § 402 (dealing with employees' trusts); *id.* § 403 (dealing with employee annuities); *id.* § 404 (dealing with deductibility of contributions); *id.* § 408 (dealing with individual retirement accounts); *id.* § 408A (dealing with Roth individual retirement accounts); *id.* § 409 (dealing with tax credit employee stock ownership plans); *id.* § 409A (dealing with nonqualified deferred compensation); *id.* § 410 (dealing with minimum participation standards); *id.* § 411 (dealing with minimum vesting standards); *id.* § 414 (dealing with pension plan definitions and special rules); *id.* § 415 (dealing with qualified plan limitations); *id.* § 416 (dealing with top-heavy plans); *id.* § 417 (dealing with survivor annuity definitions and special rules); *id.* § 420 (dealing with transfers to retiree health accounts); *id.* § 424 (dealing with stock option definitions and special rules); *id.* § 441 (dealing with taxable periods); *id.* § 447 (dealing with farming corporation methods of accounting); *id.* § 448 (dealing with cash method); *id.* § 453 (dealing with installment method sales); *id.* § 453A (dealing with installment sales by nondealers); *id.* § 453B (dealing with disposition of installment obligations); *id.* § 457 (dealing with government and tax-exempt organization deferred compensation plans); *id.* § 460 (dealing with long-term contracts); *id.* § 464 (dealing with farming deduction limitations); *id.* § 465 (dealing with at-risk limitations); *id.* § 467 (dealing with rental payments); *id.* § 468B (dealing with designated settlement funds); *id.* § 469 (dealing with passive activities); *id.* § 470 (dealing with property used by tax-exempt entities); *id.* § 475 (dealing with mark to market accounting); *id.* § 483 (dealing with interest on deferred payments); *id.* § 501 (defining tax-exempt organizations); *id.* § 503 (dealing with requirements for exemption); *id.* § 507 (dealing with termination of private foundation status); *id.* § 509 (defining private foundation); *id.* § 512 (dealing with unrelated business taxable income); *id.* § 514 (dealing with unrelated debt-finance income); *id.* § 529 (dealing with qualified tuition programs); *id.* § 530 (dealing with Coverdell education savings accounts); *id.* § 542 (defining "personal holding company"); *id.* § 544 (dealing with rules for determining stock ownership); *id.* § 613A (dealing with percentage depletion limitations); *id.* § 631 (dealing with timber, coal, or domestic iron ore sales); *id.* § 643 (dealing with estate and trust definitions); *id.* § 664 (dealing with charitable remainder trusts); *id.* § 672 (dealing with grantor trust definitions and rules); *id.* § 674 (dealing with the power to control beneficial enjoyment of trust); *id.* § 675 (dealing with trust administrative powers); *id.* § 677 (dealing with trust income for benefit of grantor); *id.* § 682 (dealing with estate or trust income in case of divorce); *id.* § 685 (dealing with funeral trusts); *id.* § 691 (dealing with income in respect of decedent); *id.* § 704(e) (dealing with distributive shares in family partnerships); *id.* § 707 (dealing with transactions between partner and partnership); *id.* § 755 (dealing with basis allocation); *id.* § 775 (defining "electing large partnership"); *id.* § 845 (dealing with reinsurance agreements); *id.* § 861 (dealing with U.S. source income); *id.* § 864(d) (dealing with related person factoring income); *id.* § 865 (dealing with rules for personal property sales); *id.* § 871 (dealing with tax on nonresident aliens); *id.* § 877 (dealing with expatriation); *id.* § 879 (dealing with community income of nonresident aliens); *id.* § 881 (dealing with income of foreign corporations not effectively connected with U.S. business); *id.* § 897 (dealing with disposition of U.S. real property interests); *id.* § 898 (dealing with foreign corporation taxable years); *id.* § 901 (dealing with foreign tax credit); *id.* § 904 (dealing with foreign tax credit limitations); *id.* § 911 (dealing with exclusion for nonresident citizens); *id.* § 912 (dealing with exemption for certain allowances); *id.* § 932 (dealing with coordination of U.S. and Virgin Island taxes); *id.* § 936 (dealing with possessions tax credit); *id.* § 953 (dealing with insurance income); *id.* § 954 (dealing with foreign base company income); *id.* § 955 (dealing with withdrawal of excluded subpart F income); *id.* § 956 (dealing with investment in U.S. property); *id.* § 958 (dealing with rules for determining stock ownership); *id.* § 965 (dealing with temporary dividends received deduction); *id.* § 971 (dealing with export trade corporation definitions); *id.* § 988 (dealing with foreign currency transactions); *id.* § 989 (dealing with foreign currency transaction definitions and special rules); *id.* § 999 (dealing with international boycotts); *id.* § 1014 (dealing with basis of property acquired from decedent); *id.* § 1015 (dealing with basis of property acquired by gift); *id.* § 1022 (dealing with property acquired from decedent dying after 12/31/2009); *id.* § 1031 (dealing with like kind exchanges); *id.* § 1033 (dealing with involuntary conversions); *id.* § 1041 (dealing with transfers between spouses or incident to divorce); *id.* § 1042 (dealing with sales to employee stock ownership plans); *id.* § 1043 (dealing with sales to comply with conflict-of-interest requirements); *id.* § 1044 (dealing with rollovers into small business investment companies); *id.* § 1059 (dealing with basis reduced by untaxed portion of extraordinary dividends); *id.* § 1059A (dealing with property imported from related persons); *id.* § 1060 (dealing with asset acquisition basis allocation); *id.* § 1092 (dealing with straddles); *id.* § 1202 (dealing with gain from sale of small business stock); *id.* § 1211 (dealing with capital losses); *id.* § 1221 (defining capital asset); *id.* § 1233 (dealing with short sales); *id.* § 1235 (dealing with sale or exchange of patents); *id.* § 1237 (dealing with real property subdivision); *id.* § 1239 (dealing with sales of depreciable property between related taxpayers); *id.* § 1244 (dealing with losses on small business stock); *id.* § 1256 (dealing with Section 1256 contracts marked to market); *id.* § 1259 (dealing with constructive sales treatment for appreciated financial positions); *id.* § 1271 (dealing with retirement, sale, or exchange of debt instruments); *id.* § 1272 (dealing with original issue discount); *id.* § 1274 (dealing with debt instruments issued for property); *id.* § 1297 (dealing with passive foreign investment companies); *id.* § 1298 (dealing with passive foreign investment company special rules); *id.* § 1313 (dealing with mitigation provision definitions); *id.* § 1361 (defining S corporation); *id.* § 1366 (dealing with pass-through of S-corporate items); *id.* § 1372 (dealing with S corporation fringe benefits); *id.* § 1397 (dealing with empowerment zone employment credit definitions and special rules); *id.* § 1398 (dealing with individual Title 11 cases); *id.* § 1400B (dealing with the District of Columbia zero percent capital gains rate); *id.* § 1400C (dealing with the District of Columbia first-time homebuyer credit); *id.* § 1400P (dealing with the Gulf Opportunity Zone housing tax benefits); *id.* § 1400S (dealing with the Gulf Opportunity Zone additional benefits); *id.* § 1402 (dealing with self-employment tax definitions); *id.* § 3402 (dealing with withholding on wages); *id.* § 3405 (dealing with withholding rules for pension income); *id.* § 3507 (dealing with advance payment of earned income credit); *id.* § 6012 (dealing with returns required); *id.* § 6013 (dealing with joint returns authorized); *id.* § 6014 (dealing with tax not computed by taxpayers); *id.* § 6015 (dealing with innocent spouse relief); *id.* § 6038 (dealing with foreign corporation and partnership information reporting); *id.* § 6038A (dealing with information reporting by authorize married couples to file joint returns[3] and allow individuals to deduct personal exemptions for dependents;[4] these two rules, however, are but the small tip of a very large iceberg. The collective importance of related-party provisions to the federal income tax system is hard to overstate.

Given the importance of these rules, it is unfortunate that tax theory lacks a broadly productive way of thinking about them. Tax scholars have instead developed multiple modes of analysis, each intended to deal with a different part of the problem. One approach, used primarily to explore issues of rate structure, attempts to identify the proper "taxable unit."[5] Is it the individual, the couple, or the family? Framed at this level of abstraction, however, the question resists clear resolution. It also fails to provide coherent answers to a

foreign-owned domestic corporations); *id.* § 6038B (dealing with notice of transfers to foreign persons); *id.* § 6038C (dealing with information with respect to foreign corporations engaged in U.S. business); *id.* § 6039C (dealing with returns of foreign persons owning U.S. real property interests); *id.* § 6045 (dealing with broker returns); *id.* § 6046 (dealing with returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock); *id.* § 6051 (dealing with employee receipts); *id.* § 6103 (dealing with confidentiality and disclosure of returns); *id.* § 6159 (dealing with payment of tax liability in installments); *id.* § 6201 (dealing with IRS assessment authority); *id.* § 6212 (dealing with notices of deficiency); *id.* § 6230 (dealing with additional administrative provisions); *id.* § 6231 (dealing with partnership definitions and special rules); *id.* § 6334 (dealing with property exempt from levy); *id.* § 6406 (dealing with abatements); *id.* § 6654 (dealing with failure to pay estimated tax); *id.* § 6663 (dealing with fraud penalty); *id.* § 6664 (dealing with penalty definitions and special rules); *id.* § 7428 (dealing with declaratory judgments regarding tax-exempt status); *id.* § 7430 (dealing with litigation costs and fees); *id.* § 7448 (dealing with judges' survivors' annuities); *id.* § 7508 (dealing with extension of time by reason of service in combat zone); *id.* § 7612 (dealing with summonses for computer software); *id.* § 7701 (dealing with definitions); *id.* § 7702B (dealing with qualified long-term care insurance); *id.* § 7703 (dealing with determination of marital status); *id.* § 7704 (dealing with publicly traded partnerships); *id.* § 7871 (dealing with Indian tribes treated as states); *id.* § 7872 (dealing with below-market loans); *id.* § 7873 (dealing with Indian fishing right income); *id.* § 7874 (dealing with expatriated entities).

3. *Id.* § 6013 (authorizing joint returns).

4. *Id.* § 151(c) (authorizing an additional exemption for dependents).

5. *See* JOSEPH M. DODGE, THE LOGIC OF TAX: FEDERAL INCOME TAX THEORY AND POLICY 129–33 (1989) (defining the taxable unit as it pertains to taxation of the family unit); MICHAEL J. GRAETZ & DEBORAH H. SCHENK, FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 455–66 (5th ed. 2005) (discussing the taxable unit and issues dealing with taxation of the family); WILLIAM A. KLEIN ET AL., FEDERAL INCOME TAXATION 14–16 (14th ed. 2006) (discussing rate schedules, the taxable unit and the marriage penalty); PAUL R. MCDANIEL ET AL., FEDERAL INCOME TAXATION: CASES AND MATERIALS 968–82 (5th ed. 2004) (discussing the taxation of families and the married couple as the unit of taxation, including marriage penalties); Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1391 (1975) (discussing whether family members and spouses should be allowed to file jointly rather than individually); Stephanie Hoffer, *Adopting the Family Taxable Unit*, 76 U. CIN. L. REV. 55, 55 (2007) (discussing the possibility of a family taxable unit); Martin J. McMahon, Jr., *Expanding the Taxable Unit: The Aggregation of the Income of Children and Parents*, 56 N.Y.U. L. REV. 60, 61 (1981) (discussing how family and spouses are treated as a single taxable unit).

myriad of urgent practical questions outside the rate structure context: "If I pay for *W*'s hospitalization, will my costs be deductible?" "If I sell property at a loss to *X*, will my loss be disallowed?" "If *Y* buys my debt from my creditor at a discount, will I have debt discharge income?" "Must I take *Z*'s income into account in determining whether I am eligible for the earned income credit?"

Under current law, the class of individuals for whom the answer is "Yes" to each of the foregoing questions is different. Section 213(a) of the Internal Revenue Code allows the taxpayer a deduction for the expenses of medical care for her *spouse or dependents*.[6] Section 267(a)(1) disallows taxpayer's losses on sales to her *siblings, half-siblings, spouse, ancestors, or lineal descendants*.[7] Section 108(e)(4) requires taxpayer to recognize debt discharge income if her debt is purchased by her *spouse, children, grandchildren, parents, or the spouse of any of her children or grandchildren*.[8] Section 32, finally, only requires that taxpayer take her *spouse's* income into account in computing adjusted gross income for earned income credit purposes.[9] There is no uniformly defined taxable unit, nor does such a uniform definition seem likely.

Sometimes theorists ask a narrower but related question: "Does the U.S. income tax system impose a penalty on marriage?"[10] The phrase "marriage penalty" normally refers only to apparent rate anomalies that result from marriage. As a result, this line of inquiry typically does not address the many

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6. *See* I.R.C. § 213(a) (dealing with the allowance of deduction for medical expenses paid during the taxable year that are not compensated for by insurance).

7. *See id.* § 267(a)(1) (dealing with the disallowance of losses on the sale or exchange of property with related parties).

8. *See id.* § 108(e)(4) (dealing with the acquisition of indebtedness by a person related to the debtor).

9. *See id.* § 32(b)(2)(B) (dealing with the calculation of earned income credits).

10. *See, e.g.*, Walter Stromquist, *Federal Income Tax Treatment of Married and Single Taxpayers*, 24 TAX NOTES 731, 731 (1979) (discussing the problems of determining the relative tax burdens of married couples and single individuals); Jonathan B. Forman, *What Can Be Done About Marriage Penalties?*, 30 FAM. L.Q. 1, 1 (1996) (discussing the unfairness of the marriage penalty); Pamela B. Gann, *The Earned Income Deduction: Congress's 1981 Response to the "Marriage Penalty" Tax*, 68 CORNELL L. REV. 468, 469 (1983) (reviewing the history of the marriage penalty and Congress's response); Michael J. McIntyre, *Individual Filing in the Personal Income Tax: Prolegomena to Future Discussion*, 58 N.C. L. REV. 469, 471 (1980) (demonstrating the weakness of the case for the individual filing rule); Robert S. McIntyre & Michael J. McIntyre, *Fixing the "Marriage Penalty" Problem*, 33 VAL. U. L. REV. 907, 907 (1999) (discussing the problem of the marriage penalty); Ann F. Thomas, *Marriage and the Income Tax Yesterday, Today, and Tomorrow: A Primer and Legislative Scorecard*, 16 N.Y.L. SCH. J. HUM. RTS. 1, 3 (1999) (discussing the problems of marriage penalties); Lawrence Zelenak, *Doing Something About Marriage Penalties: A Guide for the Perplexed*, 54 TAX L. REV. 1, 1 (2000) (discussing how married couples pay more taxes than unmarried couples).

other negative income tax consequences of marriage, nor does it address the tax consequences of other close interpersonal or business relationships.[11]

A third way of thinking about related-party problems, which I will call the "benefits and burdens of ownership" approach, focuses on the economic substance of property relationships:

> [T]axpayers, through sales and exchanges between related parties and entities, [can] easily manipulate the federal income tax regime by creating gain or loss without substantially changing their economic position with respect to the underlying properties. Taxpayers, through transactions with related parties or controlled entities, [can] technically realign their property ownership while effectively maintaining the benefits and burdens of the same property. For example, a husband [can] realize a loss upon the sale of property to his wife, but *the benefits and burdens of ownership . . . remain within the family unit.* Such transactions [can] be motivated solely to reduce overall taxation, *without any real economic change in the taxpayer's property holdings.*[12]

The House committee report on the bill that introduced the predecessor to Section 267[13] stated: "These transactions [between 'various legal entities owned by the same person or persons'] seem to occur at moments remarkably opportune to *the real party in interest* in reducing his tax liability, but, at the same time allowing him to keep *substantial control of the assets* being traded or exchanged."[14]

While more broadly useful than a simple "taxable unit" or "marriage penalty" inquiry, the "benefits and burdens of ownership" approach is problematic for several reasons. First, there exists an elaborate jurisprudence on the meaning of effective ownership for tax purposes;[15] the Code's related-

11. *See, e.g.*, Adam Carasso & C. Eugene Steuerle, *The Hefty Penalty on Marriage Facing Many Households with Children*, *in* THE FUTURE OF CHILDREN 157, 157 (2005), *available at* http://www.urban.org/UploadedPDF/1000844_marriage_penalty.pdf. This Article notes:

> Marriage penalties arise because of the combination of variable U.S. tax rates and joint, rather than individual, filing by married couples for benefits and taxes. If graduated taxes were accompanied by individual filing or if all income and transfers were taxed at a flat rate, there would be no marriage penalties.

Id.

12. George C. Koutouras et al., *Related Party Transactions*, 564 BNA TAX MANAGEMENT PORTFOLIO A-1, A-1 (2005) (emphasis added).

13. *See* I.R.C. § 267 (2002 & West Supp. 2008) (dealing with transactions between related taxpayers).

14. 81 CONG. REC. 9019 (1937) (emphasis added).

15. *See, e.g.*, Walter C. Cliff & Philip J. Levine, *Reflections on Ownership—Sales and Pledges of Installment Obligations*, 39 TAX LAW. 37, 37 (1985) (discussing the issue of ownership in relation to tax benefits); Noël B. Cunningham & Deborah H. Schenk, *Taxation*

party rules do not track that jurisprudence, and the approach makes no effort to justify the Code's departure from the jurisprudence. Second, the approach does not explain why different sets of relationships should trigger different related-party provisions. In particular, it does not explain why relatively distant relationships (e.g., a corporation majority-owned by taxpayer's grandchild's spouse)[16] trigger some such provisions while only marriage triggers others.[17] If a particular relationship allows a taxpayer "to keep substantial control of the assets being traded or exchanged,"[18] then presumably it should do so for all purposes, not just for some. Third, the approach only attempts to explain rules involving the ownership of property; it does not provide any theoretical underpinning for the many related-party rules not involving ownership. Fourth, the approach does not explain why many related-party provisions disallow only taxpayer-favorable consequences. Section 267(a)(1), for example, only disallows losses, not gains, on sales between related parties.[19] If in fact that section exists because such sales do not affect any real change in taxpayer's holdings, it arguably should authorize nonrecognition of gains as well. Finally, in many contexts the approach's underlying factual premise is simply false. If I sell my car to my brother, is it really true that the benefits and burdens of owning that car do not materially change? Is it true that I continue to exercise substantial control over its use? That I remain the "real party in interest"? Not in my family.

Without Realization: A "Revolutionary" Approach to Ownership, 47 TAX L. REV. 725, 725 (1992) (discussing the tax issues raised by ownership of property); Peter L. Faber, *Determining the Owner of an Asset for Tax Purposes*, 61 TAXES 795, 795 (1983) (discussing ownership for federal tax purposes); Edward D. Kleinbard, *Risky and Riskless Positions in Securities*, 71 TAXES 783, 784 (1993) (discussing tax implications of ownership of derivative financial instruments); Richard E. Marsh, Jr., *Tax Ownership of Real Estate*, 39 TAX LAW. 563, 563 (1986) (discussing the threshold question of ownership for taxation of real estate); David S. Miller, *Taxpayers' Ability to Avoid Tax Ownership: Current Law and Future Prospects*, 51 TAX LAW. 279, 281 (1998) (discussing the benefits and risks of being a tax owner); Alex Raskolnikov, *Contextual Analysis of Tax Ownership*, 85 B.U. L. REV. 431, 432 (2005) (discussing ownership in the context of tax); Michael H. Simonson, *Determining Tax Ownership of Leased Property*, 38 TAX LAW. 1, 1 (1984) (discussing tax ownership in the context of leasing).

16. *See, e.g.*, I.R.C. § 108(e)(4)(B) (defining who is a member of a family for the acquisition of indebtedness by a person related to a debtor).

17. *See, e.g.*, *id.* § 1041 (dealing with the transfers of property between spouses or incident to divorce).

18. 81 CONG. REC. 9019 (1937).

19. *See, e.g.*, I.R.C. § 267(a)(1) (2002 & West Supp. 2008) (defining what deductions for losses are disallowed for transactions between related taxpayers).

Most commonly, tax scholars give up on systematic analysis and focus instead on specific rules and their particular functions.[20] As a result, related-party rules vary widely and seemingly arbitrarily across the Code in both their operation and their definition of covered relationships.

This Article proposes a new way of thinking about related-party issues for federal income tax purposes. Its thesis is simple: The Code's general rules are written on the assumption that taxpayers are self-interested, unaffiliated individuals—the atomistic rationalists of the classic economic model. In general, we prefer to own property and receive income ourselves. In general, we are unwilling to transfer property or income to others simply to avoid tax. Where this assumption—which I will call the Code's "assumption of selfishness"—proves or is likely to prove incorrect, the Code makes adjustments to its otherwise applicable rules. Sometimes such adjustments facilitate transfers between interpersonally committed individuals. I may, for example, deduct the costs of medical care for my spouse and dependents.[21] Similarly, although economists view gifts as income, gifts have never been treated as income for federal tax purposes.[22] More commonly, however, the required adjustments are adverse to taxpayers; they shut down avoidance techniques or otherwise enforce the policies of the Code. If I sell property to a friend for less than its fair market value, I cannot claim any resulting "loss."[23] If I sell the same property to my spouse, child, or brother, even at fair market value, any resulting loss is still disallowed; the assumption of selfishness can no longer be relied upon to prevent an unacceptably high volume of purely tax-motivated transactions.[24] If a close family member buys my debt from my creditor at a discount, I am required to recognize debt discharge income; the

20. *See, e.g.*, Bridget J. Crawford, *The Profits and Penalties of Kinship: Conflicting Meanings of Family in Estate Tax Law*, 3 PITT. TAX REV. 1, 3 (2005) (defining "family" as applied in I.R.C. § 267(c)(4)); Anne T. Foley, *Debt Acquisition by a Related (or To-Be-Related) Party: Section 108(e)(4) and the Final Regulations*, 12 VA. TAX REV. 397, 399 (1993) (defining "family" as applied in I.R.C. § 108(e)(4)(B)); Lawrence Zelenak, *Marriage and the Income Tax*, 67 S. CAL. L. REV. 339, 398–401 (1994) (including spousal income in determining earned income tax credit eligibility).

21. *See* I.R.C. § 213(a) (allowing deductions for expenses paid during the taxable year for the medical care of the taxpayer, his spouse, or a dependent that is not covered by insurance).

22. *See id.* § 102(a) (defining gross income as not including the value of property acquired by gift, bequest, devise, or inheritance).

23. *See* Treas. Reg. § 1.1001-1(e) (2008) (dealing with transfers that are in part a sale and in part a gift).

24. *See* I.R.C. § 267(a)(1) (defining what deductions for losses are disallowed for transactions between related taxpayers); *id.* § 267(b)(1) (defining "[m]embers of a family" as one of the relationships for which deductions for losses due to transactions are disallowed).

possibility is high that the buyer is acting in my interest rather than her own.[25] Not surprisingly, I must always take my spouse's income into account in determining whether I am entitled to the earned income credit,[26] the federal government's largest anti-poverty program.[27]

Some of these special rules apply on a facts-and-circumstances basis whenever the assumption of selfishness fails, regardless of the formal relationship between the parties. Where a transfer is made other than at fair market value, for example, we may infer a gift and therefore invoke alternative rules. Disallowance of a loss on the sale of property to a friend at less than fair market value is an example of this type of provision.[28] The assignment of income rules also falls into this category.[29]

Most such special rules, however, apply only in the context of specified formal relationships—typically marriage, parent/child, or owner/business. Rules in this category generally apply even if the transaction is undertaken on arm's-length terms.[30] Some proxy for an expected failure of the assumption of selfishness is therefore necessary to invoke the special rule; specified formal relationships serve this proxy role. Not all marriages or parent/child relationships are unselfish, of course. But the assumption of selfishness fails commonly enough in such relationships that special rules are thought to be necessary. Because the likelihood of such failure varies from context to context, my theory predicts that different related-party anti-abuse rules may be triggered by different sets of formal relationships.

In an article of reasonable length, it is impossible to explore the foregoing thesis in even a significant fraction of the contexts to which it might apply. Here, I propose instead to use my thesis to answer a single question: "Should gay marriage automatically trigger related-party anti-abuse rules currently triggered by heterosexual marriage?" By "gay marriage," I mean to include both (1) gay marriages, civil unions, and domestic partnerships in jurisdictions

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25. *See id.* § 108(e)(4) (dealing with the acquisition of indebtedness by a person related to the debtor).

26. *See id.* § 32 (dealing with the earned income credit).

27. *See* Lawrence Zelenak, *Redesigning the Earned Income Tax Credit as a Family-Size Adjustment to the Minimum Wage*, 57 TAX L. REV. 301, 301 (2004) (describing the earned income tax credit as the largest federal anti-poverty program).

28. *See, e.g.*, Treas. Reg. § 1.1001-1(e)(1) (describing how there is no loss sustained on a transfer of property that is part sale and part gift if the amount realized is less than the adjusted basis).

29. *See, e.g.*, Lucas v. Earl, 281 U.S. 111, 114–15 (1930) (holding that the income from services is taxed to the person who earns it).

30. *See* I.R.C. § 4052 (2002 & West Supp. 2008) (dealing with special rules).

that recognize such formalized arrangements,[31] and (2) committed gay relationships that would likely be formalized through marriage if the

31. Currently, eleven states allow for some form of formal interpersonal relationship between same-sex parties, while another three recognize same-sex marriages entered into in other states. Massachusetts and Connecticut permit same-sex couples to marry. *See* Kerrigan v. Comm'r of Pub. Health, 289 Conn. 135, 260 (2008) (upholding the right of same-sex couples to have access to the benefits of civil marriage); Goodridge v. Dep't of Pub. Health, 798 N.E.2d 941, 1002–05 (Mass. 2003) (same). Until November 4, 2008, California also permitted same-sex couples to marry. *See In re* Marriage Cases, 183 P.3d 384, 471 (Cal. 2008) (rejecting challenge to domestic partner law). On November 4, 2008, California voters approved Proposition 8, CAL. PROPOSITION 8, http://www.voterguide.sos.ca.gov/title-sum/prop8-title-sum.htm (last visited Nov. 12, 2008) (on file with the Washington and Lee Law Review), which amended the California Constitution to limit marriage to opposite-sex couples. Jessica Garrison et al., *Voters Approve Proposition 8 Banning Same-Sex Marriage*, L.A. TIMES, Nov. 5, 2008, http://www.latimes.com/news/local/la-me-gaymarriage5-2008nov05,0,1545381.story (last visited Nov. 12, 2008) (discussing that California voters approved ban on gay marriage) (on file with the Washington and Lee Law Review). Massachusetts law further provides that marriages entered into in Massachusetts that are void in the state of residency are also void in Massachusetts. MASS. GEN. LAWS ch. 207, § 11 (2008). Pursuant to *Cote-Whitacre v. Department of Public Health*, 844 N.E.2d 623 (Mass. 2006), Massachusetts allows same-sex residents of New Mexico and Rhode Island to marry. *See* David Abel, *Same-Sex Couples from N.M. Allowed to Marry in Mass.: Bay State Agency Clarifies Ruling*, BOSTON GLOBE, July 27, 2007, at 3B (noting that same-sex couples from New Mexico and Rhode Island are eligible to marry in Massachusetts). In view of Gov. Paterson's announcement that New York will recognize same-sex marriages entered into in other states, *see* Jeremy W. Peters, *New York Backs Same-Sex Unions From Elsewhere*, N.Y. TIMES, May 29, 2008, at A1, this list may be expanded to include New York. *Id.* In the meantime, the Massachusetts Senate has voted to repeal this limitation. *See* Pam Belluck & Katie Zezima, *A 1913 Law Dies to Better Serve Gay Marriages*, N.Y. TIMES, July 16, 2008, at A1 (recounting how the Massachusetts State Senate voted to repeal a 1913 law preventing the marriage of out-of-state couples if their marriage would not be legal in their home states).

Four states recognize civil unions between same-sex partners: Connecticut, CONN. GEN. STAT. §§ 46b-38dd to 38oo (2008); New Hampshire, N.H. REV. STAT. ANN. §§ 457-A:1–8 (2007); New Jersey, A.B. 3787, 212th Leg., 2006–2007 Sess. (N.J. 2006) (enacted in response to *Lewis v. Harris*, 908 A.2d 196 (N.J. 2006)); and Vermont, VT. STAT. ANN. tit. 15, §§ 1201–1207 (2007).

Five U.S. jurisdictions recognize domestic partnerships between same-sex partners: California, CAL. FAM. CODE §§ 297–299.6 (2008); Maine, ME. REV. STAT. ANN. tit. 22, § 2710 (2007); Oregon, OR. REV. STAT. § 106.990 (2007); Oregon Family Fairness Act, H.B. 2007, 74th Or. Legis. Assem., Reg. Sess. (Or. 2007) (currently under review in *Lemons v. Bradbury*, No. CV-07-1782-MO (D. Or. Feb. 1, 2008)) (relating to new provisions for same-sex relationships), *appeal docketed*, No. 08-35209 (Apr. 29, 2008)); Washington, WASH. REV. CODE §§ 26.60.010–.901; and Washington, D.C., D.C. Code §§ 1-307.68 (2001) (making opportunity funds available for a domestic partner); *id.* § 1-612.31 (including "[d]omestic partner" in the definition of "immediate family" for leave); *id.* § 1-612.32 (stating that caring for a domestic partner is a qualified use of transferred leave); *id.* § 3-413 (providing domestic partners equivalent status as spouses in the absence of a will); *id.* § 5-113.31 (considering domestic partners family of homicide victims); *id.* § 5-113.33 (allowing domestic partners to bring a civil action against anyone who tampers with homicide evidence); *id.* § 16-1001 (including domestic partners for intrafamily offenses); *id.* § 21-2210 (giving domestic partners the same authority as jurisdiction permitted. In the remainder of this Article, I use the phrase "gay marriage" to refer to any such relationship, "gay spouse" to refer to either party to such a relationship, and "gay couple" to refer to the two parties collectively. I address the issue of formalization separately in Part IV.B.3, below.

My choice of question is not arbitrary. To test my thesis across the full range of Code provisions I purport to explain, I need a relationship that might plausibly be covered by the many rules limited solely to spouses. Spouses are related parties for purposes of *all* related-party rules applicable to individuals; the same cannot be said of any other relationship. I also need a relationship that is not a covered relationship for purposes of *any* of the related-party rules. And I need a relationship that involves significant long-term interpersonal commitment, with the intertwining of personal finances that commonly accompanies such commitment. Gay marriage is the only relationship I can think of that satisfies all these criteria.

It is clear that gay couples are not "married" for tax purposes, nor are they "spouses" within the meaning of the Code. Section 3 of the Defense of Marriage Act ("DOMA"),[32] enacted in 1996, provides as follows:

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spouses regarding health care choices in the absence of a durable power of attorney); *id.* § 32-501 (including domestic partners for family and medical leave); *id.* § 32-701 (clarifying the requirements for domestic partnership and family and medical leave, including children of domestic partners); *id.* § 32-704 (allowing for domestic partner visitation in medical facilities); *id.* § 32-705 (explaining health care benefits for domestic partnerships); *id.* § 32-706 (banning domestic partners from having both individual and family health insurance); *id.* § 42-1102 (exempting property deeds between domestic partners for tax purposes); *id.* § 42-3404.02 (considering domestic partners family for "rent-to-buy" options); *id.* § 42-3651.05 (stating that domestic partners may not be appointed as receivers for rental housing); *id.* § 47-858.03 (entitling domestic partners to home rehabilitation deduction); *id.* § 47-902 (stating that transfers between domestic partners are tax exempt).

Hawaii recognizes same-sex "reciprocal beneficiaries." *See* Reciprocal Beneficiaries Act, 1997 Hawaii Sess. Laws 1211 (creating a new institution of "reciprocal beneficiaries" open to couples who cannot marry, such as same-sex couples).

Outside the United States, same-sex marriage is recognized in five countries: Netherlands, Belgium, Canada, Spain, and South Africa. Melissa Durand, *From Political Questions to Human Rights: The Global Debate on Same-Sex Marriage and Its Implications for U.S. Law*, 5 REGENT J. INT'L L. 269, 270 (2007). Denmark, Norway, Sweden, Iceland, and Finland recognize same-sex unions. Daniel R. Pinello, *Gay Marriage: For Better or for Worse? What We've Learned from the Evidence*, 42 LAW & SOC'Y REV. 227, 227 (2008) (book review).

32. 1 U.S.C. § 7 (2000). Much has been written about DOMA. *See generally* Jennifer Gerarda Brown, *Extraterritorial Recognition of Same-Sex Marriage: When Theory Confronts Praxis*, 16 Q.L.R. 1 (1996); Stanley E. Cox, *DOMA and Conflicts Law: Congressional Rules and Domestic Relations Conflicts Law*, 32 CREIGHTON L. REV. 1063 (2005); James M. Donovan, *DOMA: An Unconstitutional Establishment of Fundamentalist Christianity*, 4 MICH. J. GENDER & L. 335 (1997); Andrew Koppelman, *Dumb and DOMA: Why the Defense of Marriage Act is Unconstitutional*, 83 IOWA L. REV. 1 (1997); Andrew Koppelman, *Interstate Recognition of Same-Sex Marriages and Civil Unions: A Handbook for Judges*, 153 U. PA. L.

> 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.[33]

It is possible for one gay spouse to qualify as a "dependent" of the other,[34] and thereby obtain the benefit of many taxpayer-favorable related-party

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REV. 2143 (2005); Joseph W. McKnight, *Family Law: Husband and Wife*, 58 SMU L. REV. 877 (2005); Linda Silberman, *Same-Sex Marriage: Refining the Conflict of Laws Analysis*, 153 U. PA. L. REV. 2195 (2005); Mark P. Strasser, *"Defending" Marriage in Light of the Moreno-Cleburne-Romer-Lawrence Jurisprudence: Why DOMA Cannot Pass Muster After Lawrence*, 38 CREIGHTON L. REV. 421 (2005); Lynn D. Wardle, *Non-Recognition of Same-Sex Marriage Judgments under DOMA and the Constitution*, 38 CREIGHTON L. REV. 365 (2005); Evan Wolfson & Michael F. Melcher, *DOMA's House Divided: An Argument Against the Defense of Marriage Act*, 44-SEP. FED. LAW. 30 (1997); Evan Wolfson & Michael F. Melcher, *The Supreme Court's Decision in* Romer v. Evans *and Its Implications for the Defense of Marriage Act*, 16 Q.L.R. 217 (1996); Angela M. Biamonte, Note, *The Progressive's View of the Defense of Marriage Act and Its Conflict with Conservative Society*, 4 WIDENER L. SYMP. J. 325 (1999); Leonard G. Brown III, Comment, *Constitutionally Defending Marriage: The Defense of Marriage Act,* Romer v. Evans *and the Cultural Battle They Represent*, 19 CAMPBELL L. REV. 159 (1996); Charles J. Butler, Note, *The Defense of Marriage Act: Congress's Use of Narrative in the Debate over Same-Sex Marriage*, 73 N.Y.U. L. REV. 841 (1998); Diane M. Guillerman, Comment, *The Defense of Marriage Act: The Latest Maneuver in the Continuing Battle to Legalize Same-Sex Marriage*, 34 HOUS. L. REV. 425 (1997); Heather Hamilton, Comment, *The Defense of Marriage Act: A Critical Analysis of its Constitutionality under The Full Faith and Credit Clause*, 47 DEPAUL L. REV. 943 (1998); Jon-Peter Kelly, Note, *Act of Infidelity: Why the Defense of Marriage Act is Unfaithful to the Constitution*, 7 CORNELL J.L. & PUB. POL'Y 203 (1997); Kevin H. Lewis, Note, *Equal Protection after* Romer v. Evans*: Implications for the Defense of Marriage Act and Other Laws*, 49 HASTINGS L.J. 175 (1997); Note, *Litigating the Defense of Marriage Act: The Next Battleground for Same-Sex Marriage*, 117 HARV. L. REV. 2684 (2004); Kristine J. Namkung, Comment, *The Defense of Marriage Act: Sex and the Citizen*, 24 U. HAW. L. REV. 279 (2001); Barbara A. Robb, Note, *The Constitutionality of the Defense of Marriage Act in the Wake of* Romer v. Evans, 32 NEW ENG. L. REV. 263 (1997); Anita Y. Woudenberg, Note, *Giving DOMA Some Credit: The Validity of Applying Defense of Marriage Acts to Civil Unions Under the Full Faith and Credit Clause*, 38 VAL. U. L. REV. 1509 (2004).

33. 1 U.S.C. § 7 (2000).

34. I.R.C. § 152(d)(2)(H) (2002 & West Supp. 2008) defines the term "dependent" as a "qualifying child" or a "qualifying relative." *Id.* The latter term includes "an individual (other than [taxpayer's spouse]) who . . . has the same principal place of abode as the taxpayer and is a member of the taxpayer's household," *id.*, provided that that individual has gross income less than the exemption amount ($2,000), receives over half her support from the taxpayer, and is not a qualifying child of any taxpayer. I.R.C. § 152(d)(1). Treasury Regulation § 1.152-1(b) (2008) confirms that "[i]t is not necessary . . . that the dependent be related to the taxpayer." *Id.* The regulation further provides that "[a]n individual is not a member of the taxpayer's household if at any time during the taxable year of the taxpayer the relationship between such individual and the taxpayer is in violation of local law." *Id.* This clearly precludes dependent

rules.[35] But gay marriage by itself never invokes *any* related-party rules—taxpayer-favorable or anti-abusive.

Nevertheless, gay marriage does commonly involve a failure of the assumption of selfishness. Gay spouses commonly pool their income, assets, expenses, and liabilities, just as heterosexual spouses do. In jurisdictions that formally recognize same-sex relationships, nontax law sometimes even affects such pooling de jure, giving formal recognition to the de facto pooling that would otherwise occur. In sum, gay marriage is an ideal context in which to test my thesis.

If the "taxable unit" approach captures the essence of the related-party problem, the fact that gay marriage is not a listed relationship should only trouble us if we already believe, for reasons external to tax, that gay marriage should be treated the same as heterosexual marriage. Logically, it is possible to believe that heterosexual couples are appropriate taxable units but that gay couples are not. There is nothing inherent in taxable unit analysis—as opposed to moral theory—that requires us to treat the two similarly.

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status for one living in an adulterous relationship. *See* Lindsay Brooke King, Note, *Enforcing Conventional Morality Through Taxation?: Determining the Excludability of Employer-Provided Domestic Partner Health Benefits Under Sections 105(B) and 106 of the Internal Revenue Code*, 53 WASH. & LEE L. REV. 301, 303 (1996) (discussing domestic partners who qualify as dependents of the employee). Since *Lawrence v. Texas*, 539 U.S. 558, 578 (2003) (declaring a Texas law that criminalizes the sexual conduct between same-sex partners to be unconstitutional), however, it seems unlikely that a nonadulterous adult gay relationship would be "in violation of local law" for this purpose. *Id.*

35. *See, e.g.*, I.R.C. § 21 (crediting expenses for household services or care of qualifying individual, incurred to enable taxpayer to work; qualifying individual includes any dependent who is physically or mentally incapable of caring for himself and has same principal place of abode as taxpayer for more than half of taxable year); *id.* § 25A (crediting a portion of qualified tuition for, among others, any dependent); *id.* § 35 (crediting a part of costs incurred by TAA or PBGC recipients for health care insurance for, among others, any dependent); *id.* § 105 (excluding amounts received by reason of health or accident insurance for medical care of, among others, any dependent); *id.* § 119 (excluding meals or lodging furnished for the convenience of an employer to, among others, any dependent); *id.* § 120 (excluding amounts paid by employer under qualified legal services plan to provide personal legal services for, among others, any dependent); *id.* § 135 (excluding income from qualified savings bonds where taxpayer pays higher educational expenses of, among others, any dependent); *id.* § 151 (dealing with personal exemption for dependents); *id.* § 162(*l*) (allowing deduction to self-employed taxpayers for costs of health care insurance for, among others, any dependent); *id.* § 213 (dealing with deduction for medical expenses of, among others, any dependent); *id.* § 217 (dealing with deduction for moving expenses of, among others, any dependent); *id.* § 221 (dealing with deduction for interest on debt incurred to pay qualified higher education expenses for, among others, any dependent); *id.* § 222 (dealing with deduction of qualified tuition for, among others, any dependent); *id.* § 223 (dealing with deduction of amounts paid into health savings account to pay medical expenses of, among others, any dependent); *id.* § 911 (excluding citizens living abroad of housing expenses for, among others, any dependent residing with them).

If the "marriage penalty" approach captures the essence of the problem, fewer still should be troubled by the Code's failure to treat gay marriage in a manner comparable to heterosexual marriage. Marriage penalty analysis invites us to worry about the fact that singles are sometimes taxed more favorably than married couples. Gay couples, for this purpose, are simply a small part of a larger class of favored singles—a group comprising some 50.3% of American households.[36] Any purported marriage penalty does not discriminate in favor of gays; it discriminates, if at all, in favor of this 50.3%.

But if my thesis is correct—one of the principal purposes of the related-party rules is to prevent tax-abusive transactions whenever the assumption of selfishness fails—then we should all be troubled by the tax-abusive consequences of not including gay marriage as a listed relationship automatically invoking those rules. This should be true even if, for nontax reasons, we are opposed to gay marriage itself.

Of existing justifications for the Code's related-party provisions, the "benefits and burdens of ownership" approach comes closest to justifying application of at least some related-party rules to gay couples. If a taxpayer sells property at a loss to her same-sex spouse, presumably the benefits and burdens of ownership remain within the "family unit" just as they would in a heterosexual couple; gay marriage should therefore arguably be a relationship listed in Section 267(b). This facially plausible argument, of course, fudges the family unit issue. Should a gay couple be treated as a family unit for benefits

36. *See* Sam Roberts, *It's Official: To Be Married Means to Be Outnumbered*, N.Y. TIMES, Oct. 15, 2006, at 122 (explaining why statistically married couples are now in the minority as a proportion of American households). The percentage of households comprised of heterosexual married couples has gone down from about 84% in 1930 to about 56% in 1990. *Id.* The 2000 census found a total of 658,711 same-sex unmarried-partner households, male and female, such households each comprising about half of this number. U.S. Census Bureau, *QT-P18: Marital Status by Sex, Unmarried-Partner Households, and Grandparents as Caregivers: 2000*, http://factfinder.census.gov/servlet/QTTable?_bm=y&-geo_id=01000US&qr_name=DEC_2000_SF3_U_QTP18&-ds_name=DEC_2000_SF3_U&-_lang=en&-_sse=on (last visited Oct. 3, 2008) (on file with the Washington & Lee Law Review). Same-sex unmarried-partner households therefore comprised 0.6% of the United States' 105,480,101 households. U.S. Census Bureau, *QT-P10: Households and Families: 2000*, http://factfinder.census.gov/servlet/QTTable?_bm=y&-geo_id=01000US&-qr_name=DEC_2000_SF1_U_QTP10&-ds_name=DEC_2000_SF1_U&-_lang=en&-redoLog=false&-_sse=on (last visited Oct. 3, 2008) (on file with the Washington & Lee Law Review). Not all reported same-sex unmarried-partner households, of course, necessarily involved long-term committed relationships. Conversely, it is possible that the number of same-sex unmarried-partner households was significantly underreported by reason of the stigma attached to such arrangements in many parts of the country. Since the 2000 census, the number of self-reported same-sex couples has risen to 776,000. Roberts, *supra*, at 122.

and burdens of ownership purposes? The "benefits and burdens of ownership" approach by itself does not answer this question.

I submit that the answer should be yes. But the reason is that gay marriage involves a probable failure of the assumption of selfishness. Gay spouses are likely to share income, expenses, assets, and liabilities; the benefits and burdens of ownership are therefore likely to be shared as well—just as they are between heterosexual spouses. To reach this conclusion, however, the benefits and burdens of ownership approach requires that we first assume that gay marriage involves a failure of the assumption of selfishness; it cannot get there on its own. In addition, as I have already noted, benefits and burdens of ownership analysis cannot explain related-party rules generally; by its terms it only purports to address a limited subset of those rules.

This Article proceeds in three parts. Part II focuses on five sample related-party rules applicable to the extended family and its interests—parents, children, siblings, more remote relations, and the family's controlled business entities. Of existing approaches, the "benefits and burdens of ownership" approach is most commonly invoked to explain related-party rules in this category; "taxable unit" and "marriage penalty" analyses are almost never used for this purpose. All extended family anti-abuse rules apply to spouses as well—although not, of course, to gay spouses. In addition, when one gay spouse gives birth to or adopts a child, some jurisdictions do not allow the other to formalize the parent/child relationship that often in fact results.[37] In consequence, many gay parents can also undertake tax-motivated transactions with children they consider emotionally theirs without triggering any of these more broadly applicable related-party anti-abuse rules.

In each of the contexts explored in Part II, readers committed to fair taxation are likely to be troubled by the consequences of not including gay marriage as a listed relationship automatically invoking the rule in question, regardless of their views on the merits of gay marriage itself. Because gay marriage involves a probable failure of the assumption of selfishness, tax-driven transactions that would be unattractive to self-interested, unaffiliated individuals remain attractive and open to gay spouses. As a result, well-advised gay couples can often arrange their affairs so as to face systematically lower federal income tax liabilities than their identically-situated heterosexual counterparts.

Part III then focuses on Code provisions specific to marriage, the context in which "taxable unit" and "marriage penalty" analyses currently hold sway.

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37. *See generally Legal Recognition of LGBT Families* (2008), http://www.nclrights.org/site/DocServer/Legal_Recognition_of_LGBT_Families.pdf?docID=2861.

My thesis here is that many such provisions—including joint return filing—are in fact anti-abuse rules, required because we anticipate a failure of the assumption of selfishness in marriage. Spouses commonly share income, expenses, assets, and liabilities. It was to address spousal income-splitting—made possible only by a failure of the assumption of selfishness—that Congress first authorized the filing of joint returns.[38] But the tax avoidance possibilities created by expense, asset, and liability splitting, Part III argues, are also troubling. Joint return filing and spousal attribution rules largely solve these problems in the case of heterosexual married couples. Gay couples, however, are not permitted to file joint returns, are not subject to the unfavorable married-filing-separately rates intended to induce heterosexual married couples to file such returns, and are exempt from spousal attribution rules. Like Part II, Part III concludes that even readers opposed to gay marriage on nontax grounds are likely to be troubled by the consequences.

Finally, Part IV seeks to draw general lessons from the diverse technical threads of the first two parts. Part IV.A compares the explanatory power of various modes of related-party-provision analysis. It concludes that the thesis of this Article—that one of the principal purposes of the related-party rules is to prevent tax-abusive transactions wherever the assumption of selfishness is likely to fail—does a better job of explaining a broader range of the Code's related-party provisions than any of its competitors.

Part IV.B explores possible Congressional responses to the various unintended tax advantages of gay marriage detailed in the first two parts. It is, of course, beyond the scope of this Article to examine the issue of solutions comprehensively in the context of all 250 potentially-implicated Code sections. Nevertheless, Part IV.B suggests that the only unambiguously effective way to prevent gay couples from undertaking the broad range of tax-driven transactions now prohibited to heterosexual married couples by those Code sections is to list gay marriage as one of the proxy relationships that automatically invokes the pertinent anti-abuse rules—in other words, to treat gay marriage as analogous to "marriage" for related-party purposes. Even this by itself, however, will not be enough. A formal spousal relationship needs to be made available to gays, and it needs to be attractive enough to induce gay couples to undertake it voluntarily—just as heterosexuals marry despite the tax costs. In the absence of an attractive formal status that then invokes related-party anti-abuse rules, well-advised gay couples are, and will continue to be, permitted to pay systematically lower federal income taxes than heterosexual

38. *See* Patricia A. Cain, *Taxing Families Fairly*, 48 SANTA CLARA L. REV. 805, 815–17 (2008) (discussing Congress's reasoning in adopting joint tax filing).

married couples—a result unlikely to be acceptable to a majority of Americans in the long run. There is, moreover, a risk that if Congress fails to address the problem and awareness of the problem spreads in the public consciousness, heterosexuals will begin to think more seriously about the tax advantages of foregoing marriage.

Two caveats before I begin. First, this is not an Article about the taxation of gays generally. The Code clearly discriminates against gays in a variety of ways; others have written extensively about such discrimination.[39] I focus here instead on the ways the Code inadvertently discriminates *in favor* of gay marriage[40]—in other words, on one of Justice Jackson's famous "invisible boomerangs."[41] Second, this is not an Article for or against gay marriage itself. It is an Article on tax theory. Part IV.B assumes that the institution of heterosexual marriage is unlikely to collapse or sustain significant damage if gay marriage is recognized for tax purposes. This is, however, a factual assumption, not a normative one.

II. Related-Party Rules Applicable to Extended Families

I begin with a sampling of related-party rules applicable to extended families and some of the tax avoidance techniques they are designed to prevent.

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39. *See, e.g.*, Patricia A. Cain, *A Review Essay: Tax and Financial Planning for Same-Sex Couples: Recommended Reading*, 8 LAW & SEXUALITY 613, 615 (1998) (considering the special problems of gay and lesbian couples with regards to estate planning); Patricia A. Cain, *Death Taxes: A Critique from the Margin*, 48 CLEV. ST. L. REV. 677, 678 (2000) (discussing how gay and lesbian couples are marginalized with regard to taxation); Patricia A. Cain, *Dependency, Taxes, and Alternative Families*, 5 J. GENDER RACE & JUST. 267, 268 (2002) (expounding on nontraditional families, including same-sex partners); Patricia A. Cain, *Federal Tax Consequences of Civil Unions*, 30 CAP. U. L. REV. 387, 389 (2002) (describing the application of federal tax law to civil unions); Patricia A. Cain, *Heterosexual Privilege and the Internal Revenue Code*, 34 U.S.F. L. REV. 465, 465 (2000) (explaining how the Internal Revenue Code treats same-sex couples differently); Wendy S. Goffe, *Estate Planning for the Unmarried Couple/Non-Traditional Family*, SK093 ALI-ABA 1285, 1289 (2005) (discussing tax benefits available only to heterosexual married couples); Anthony C. Infanti, *The Internal Revenue Code as Sodomy Statute*, 44 SANTA CLARA L. REV. 763, 765 (2004) (expressing astonishment that scholars can analyze equal treatment of same-sex couples using cost-benefit analysis); Christopher T. Nixon, *Should Congress Revise the Tax Code to Extend the Same Tax Benefits to Same-Sex Couples as are Currently Granted to Married Couples?: An Analysis in Light of Horizontal Equity*, 23 S. ILL. U. L.J. 41, 43 (1998) (arguing that treating same-sex couples differently for tax purposes is not a sound policy).

40. *See also* William P. Kratzke, *The Defense of Marriage Act (DOMA) is Bad Income Tax Policy*, 35 U. MEM. L. REV. 399, 406 (2005) (describing how same-sex couples can seek to maximize individual gains due to the effects of DOMA).

41. *Supra* note 1 and accompanying text.

The techniques outlined in this Part are intended to be illustrative; I have chosen them because of their potential for widespread abuse and their accessibility to nontax readers. Diligent analysis would likely identify hundreds, perhaps thousands, of other such techniques. I should also note that when I have presented versions of this Article at American Bar Association Tax Section meetings,[42] practitioners have told me that they are already using techniques outlined in this Part to minimize their gay clients' taxes. In other words, these are not hypothetical techniques; they are already in use.

A. *Deferring Recognition of Gain on a Sale of Property for Cash*

When a taxpayer sells appreciated property for cash, the Code generally requires that she recognize and report any resulting gain concurrently. A simple technique for circumventing this requirement is available to gay couples but not to single taxpayers or heterosexual married couples.

Assume that Spouse *A* owns a painting for which she originally paid \$10,000. The painting is now worth \$50,000. She wants to sell it for cash and has identified a willing buyer. The problem, of course, is that if she goes through with the sale as contemplated, she will recognize \$40,000 in taxable gain. She therefore restructures the transaction as follows.[43] Assume that Spouse *A* is married to Spouse *B*. Spouse *A* sells the painting to Spouse *B* in exchange for Spouse *B*'s genuine note in the face amount of \$50,000, payable with adequate stated interest in twenty years' time. In the absence of special related-party provisions, under the Section 453[44] installment sale rules Spouse *A* will not have to recognize her gain until Spouse *B* makes payment on the note—that is, twenty years later.[45] Nevertheless, as a result of this preliminary

42. ABA Tax Section Fall Meeting, Diversity Committee Luncheon Speaker, *Managing Income, Property, and Debt: Inter Vivos Techniques for Unmarried Couples*, Vancouver, BC, Sept. 29, 2007; ABA Tax Section Annual Meeting, Domestic Relations Committee, Panelist, *Tax Planning for Married Couples and Unmarried Couples: Breaking Up Is Hard To Do*, Washington, DC, May 5, 2006; ABA Tax Section Midyear Meeting, Teaching Taxation Committee, Panelist, *Perspectives on Taxing Same Sex and Unmarried Couples*, San Diego, CA, Feb. 3, 2006.

43. My hypothetical assumes that no commitment has yet been made to sell to the identified buyer. *See, e.g.*, Estate of Applestein v. Comm'r, 80 T.C. 331, 344 (1983) (finding that the seller had entered into a binding contract to sell); Salvatore v. Comm'r, 29 T.C.M. (CCH) 89, 89 (1970) (noting that there had been a contract selling property to an identified buyer).

44. *See* I.R.C. § 453 (2002 & West Supp. 2008) (dealing with installment method sales).

45. If necessary, the couple can defer gain recognition further by extending payment on the note. The gain is not recognized until the principal amount of the note is actually paid.

inter-spousal sale, Spouse *B* takes the painting with a basis of $50,000. She then sells the painting to the third-party buyer for $50,000 cash. Because she has a basis in the painting equal to her amount realized on the cash sale, she recognizes no gain on that sale. Our couple has just sold the painting and received the full sale price in cash without recognizing any current gain; all relevant gain is deferred until the note given by Spouse *B* in the preliminary inter-spousal sale is paid.

Note that this technique is likely to be unattractive to single taxpayers. The assumption of selfishness holds true: The unattached single wants the cash herself, and she wants it now. If she is willing to forego the immediate receipt of cash, she can sell the painting on an installment basis herself. This is not thought to be abusive because it requires that she forego immediate receipt of the sales proceeds. No further rules are therefore thought to be necessary to prevent abuse of this technique by unattached singles.

Heterosexual spouses, by contrast, may be perfectly willing to use the technique abusively. If the spouses pool their finances, Spouse *A* may not care that the cash ends up in Spouse *B*'s hands. If the spouses are heterosexual, however, two separate related-party rules get in the way. First, Section 1041 treats sales between "spouses" as nonrecognition events.[46] Sales between heterosexual spouses, even at fair market value, therefore do not trigger gain; nor does the purchasing spouse receive a stepped-up basis in the transferred property. As a result, when Spouse *B* sells the painting to the third-party buyer for cash, she recognizes the couple's full gain.

Section 453(e)(1) also prevents use of the technique by heterosexual married couples. Section 453(e)(1) deals with the situation in which taxpayer disposes of property to a "related person" and that "related person" then disposes of the same property to a third party—precisely our situation.[47] Heterosexual spouses are clearly "related persons" for this purpose. In such circumstances, the special rule provides that the amount realized on the second sale is deemed received by the first seller at the moment of the second sale—in other words, it accelerates recognition of gain on the first sale.[48] Applied to our hypothetical transaction, Section 453(e)(1) tells us that Spouse *A* will be deemed to receive payment on the sale to Spouse *B* as soon as Spouse *B* sells the property to the third-party buyer. Under the installment sales rules, Spouse *A* recognizes income as soon as she is deemed to receive payment. The effect

46. *See* I.R.C. § 1041 (dealing with transfers between spouses or incident to divorce).

47. *Id.* § 453(e)(1).

48. *See id.* § 453(e)(1)(B) (dealing with the disposition of property by the related person before the person making the first disposition receives all payments).

of Section 453(e)(1), therefore, is to prevent Spouse *A* from deferring her gain beyond the second sale. As soon as Spouse *B* sells the property to the third-party buyer for cash, Spouse *A* recognizes the couple's full gain.

Neither such related-party rule, however, applies to gay couples. Gay spouses are not "spouses" for federal income tax purposes; Section 1041 is therefore irrelevant. Section 453(e)(1) applies only to "related persons," defined by cross-references to Sections 318[49] and 267.[50] A Section 453(e)(1) "related person" includes taxpayer's heterosexual spouse, siblings, half-siblings, ancestors, and lineal descendants.[51] It does not include her same-sex spouse, even if they are legally married. As a result, a preliminary inter-spousal fair-market-value installment sale between gay spouses will give the second spouse a stepped-up basis without requiring the first to recognize gain currently; when the second then sells the property to the outside world for cash, she recognizes no gain. Using this technique, gay couples can lawfully defer gain from the sale of any property that qualifies for installment sale treatment, while at the same time receiving the full sales proceeds in cash.[52]

B. Avoiding Recognition of Debt Discharge Income

In general, when debt is discharged without payment, the debtor recognizes income in the amount of the discharge.[53] That same discharge can

49. *See id.* § 318 (dealing with constructive ownership of stock).

50. *See id.* § 267 (dealing with transactions between related taxpayers).

51. *Id.* § 453(e)(1) (dealing with second dispositions by related persons).

52. This technique is not, therefore, available for sales of inventory, *id.* § 453(b)(2)(B) (2008), most dealer dispositions, *id.* § 453(b)(2)(A), or sales of publicly tradable property, § 453(k)(2). Ironically, because of community property rules and *Poe v. Seaborn*, 282 U.S. 101, 118 (1930) (holding that a husband and a wife are entitled to file separate returns, each treating one-half of the community income as his or her respective income), use of this technique by California domestic partners is limited to sales of property deemed "separate" under those rules. CAL. FAM. CODE §§ 2500–2502 (2008) (defining "separate property"). Community property is deemed owned 50% by each partner. *Id.* §§ 2550–2556 (2008) (dividing California community property fifty-fifty). A sale of each partner's 50% interest to the other for offsetting installment obligations followed by a sale to a third party would probably be collapsed and ignored. *Id.* §§ 2550–2556 (2008) (detailing sale of community property). Should Congress fully overrule *Seaborn*, however, this technique would become available to California domestic partners as well. Further discussion of *Seaborn* and the community property rules appears in Parts II.A and III.B.1 below.

53. The discharge of indebtedness doctrine is far more complex than the statement in text acknowledges. *See generally* Theodore P. Seto, *Inside* Zarin, 59 SMU L. REV. 1761, 1761–62 (2006) (noting that the IRS saw a taxable debt discharge for David Zarin); Theodore P. Seto, *The Function of the Discharge of Indebtedness Doctrine: Complete Accounting in the Federal Income Tax System*, 51 TAX L. REV. 199, 200–02 (1997) (discussing the rules for the discharge

be restructured as a purchase: The debtor now purchases his debt from the creditor for less than its face amount—e.g., for pennies on the dollar. To the extent that the face amount of the debt exceeds the purchase price, this remains a debt discharge in substance and is therefore treated as a debt discharge for federal income tax purposes.[54] Restructuring a debt discharge as a purchase by debtor, therefore, does not change its tax treatment. But what if someone else, someone taxpayer trusts implicitly, purchases the debt for the same pennies-on-the-dollar amount?

Assume that Spouse *A* owes $100,000 to a third-party creditor, which debt is to be discharged in exchange for a $5,000 payment in circumstances that would normally result in the recognition of $95,000 of debt discharge income. Obviously, Spouse *A* would prefer not to have to report $95,000 of income by reason of the transaction. Let us therefore restructure the transaction as a third-party purchase. Now Spouse *B* buys Spouse *A*'s debt from the third-party creditor for the same $5,000 without discharging it. Spouse *A* will continue to owe the same $100,000 to Spouse *B*, but because they pool their finances, Spouse *A* does not care. The couple no longer owes anything to the outside world. Nevertheless, in the absence of special rules, no taxable debt discharge has occurred.

Section 108(e)(4) denies this technique to heterosexual married couples by providing that purchase of the debt by a "related person" is to be treated as a purchase by the debtor herself.[55] In our hypothetical, purchase of the debt by Spouse *B* is treated as purchase of the same debt by Spouse *A*—which triggers the very income the couple is trying to avoid. This special rule is not limited to heterosexual spouses; "related person" is defined for this purpose to include, among others, taxpayer's heterosexual spouse, children, grandchildren, and parents, and the heterosexual spouses of taxpayer's children or grandchildren.[56] But again, Section 108(e)(4) does not extend to gay spouses. As a result, gay couples should be able to structure their debt discharges to avoid income recognition in many, if not most, situations.[57]

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of indebtedness). The complexities of the doctrine are irrelevant, however, for present purposes.

54. *See* United States v. Kirby Lumber Co., 284 U.S. 1, 3 (1931) (noting that repurchase of a debt for less than face value triggers taxable gain).

55. *See* I.R.C. § 108(e)(4) (2002 & West Supp. 2008) (dealing with the acquisition of indebtedness by a person related to the debtor).

56. Treasury Regulations extend application of I.R.C. § 108(e)(4) to situations in which someone acquires a taxpayer's indebtedness in anticipation of becoming a "related person" with respect to taxpayer. Treas. Reg. § 1.108-2(c) (2008).

57. Use of this technique by California domestic partners is limited because community liabilities are treated as owed half by each spouse. *See* CAL. FAM. CODE §§ 2620–2628 (2008) (detailing debts and liabilities involving community property). As a result, when Spouse *B*

Note that the technique is unlikely to be attractive to single taxpayers. Because "related person" includes much of taxpayer's extended family, the set of trusted potential co-conspirators to whom taxpayer can turn is significantly limited. Taxpayer's lover—who has yet to make the long-term commitment involved in marriage—may not be thought sufficiently trustworthy for this purpose. It is true that a single taxpayer may still be able to undertake the transaction with a trusted brother or sister, but this would be true regardless of taxpayer's marital status or sexual orientation.[58] Unlike singles or heterosexual married taxpayers, married gay taxpayers have committed debt-discharge-income-avoidance partners conveniently at hand.

The foregoing techniques allow gay couples to avoid reporting income—potentially very large amounts of income—in circumstances in which identically situated heterosexual couples would clearly have to report such income. They are, however, illustrative, not exhaustive. Because gay marriage does not by itself invoke *any* related-party anti-avoidance rule, many other such income-avoidance techniques exist and remain open to gay couples.

C. Creating Artificial Tax Losses

I turn next to a technique with a different objective: To create lawful artificial tax losses that can then be used to offset unrelated income on gay couples' returns. Again, the technique I describe is likely to be uninteresting to single taxpayers. It would likely be attractive to heterosexual married couples but is effectively prohibited to such couples by Section 267(a)(2), another related-party anti-abuse rule.[59] And again, the technique described here is

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purchases the debt from the third-party creditor, she triggers half the debt discharge income. In addition, if she purchases the debt using community property, half of the purchase price is treated as coming out of Spouse *A*'s property. It is likely, in these circumstances, that each spouse will thereby be treated as having purchased the half of the debt that she is treated as owing. If so, the purchase by Spouse *B* will result in recognition of all relevant debt discharge income. Full use of this technique by gay couples to whom community property rules apply will therefore be limited to situations in which Spouse *B* can use separate property to purchase a separate liability of Spouse *A* from the third-party creditor—as a practical matter, a fairly narrow context. Should Congress fully overrule *Seaborn*, or should *Seaborn* be inapplicable to gay spouses in this regard, this technique would become fully available to California same-sex domestic partners as well.

58. The omission of siblings from Section 108(e)(4) presumably represents a Congressional judgment that taxpayers are unlikely to undertake this particular circumvention technique with siblings. *See* I.R.C. § 108(e)(4) (dealing with the acquisition of indebtedness by a person related to the debtor).

59. *See id.* § 267(a)(2) (matching deduction and payee income item in the case of expenses and interest).

intended to be illustrative only; in the absence of applicable related-party anti-avoidance rules, many other techniques for the creation of artificial tax losses exist as well.

In general, taxpayers compute their income and losses using one of two methods of accounting: accrual or cash. In lay terms, under the accrual method, income is recognized when earned;[60] deductions are taken, for the most part, when the related liability is incurred[61]—payment is not generally required.[62] By contrast, under the cash method, income is recognized when payment is received;[63] deductions are taken when the related liability is paid.[64] Under the cash method, therefore, payment is key. This creates the possibility that if payor uses the accrual method and payee the cash method and the payor incurs but does not pay an obligation, the parties can create a deduction for the payor while not generating any current income to the payee. There is no general requirement that parties to a single transaction use the same method of accounting; in the unrelated party context, such a requirement would be extremely difficult to administer. If we assume that taxpayers are self-interested and financially independent, moreover, there is no need for any such generally applicable requirement.

Assume, however, that Spouse *A* operates an accrual method business. Her business obligates itself to make a deductible deferred payment for value to Spouse *B*, who uses the cash method of accounting. Economically, the couple has just agreed to move money from one pocket to another—from Spouse *A* to Spouse *B*. For tax purposes, Spouse *A* gets an immediate deduction, while Spouse *B* reports no income until payment is actually made. In other words, by

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60. *See* Treas. Reg. § 1.451-1(a) (2008) ("Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.").

61. *See id.* § 1.461-1(a)(2) ("Under an accrual method of accounting, a liability . . . is incurred, and generally is taken into account for Federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability.").

62. The economic performance rules of I.R.C. § 461(h) do require that payment be made before an accrual method taxpayer may take the relevant deduction in a limited range of cases. *See* I.R.C. § 461(h)(2)(C) (2002 & West Supp. 2008) (dealing with liabilities arising under any workers' compensation act or out of any tort); *see also* Treas. Reg. § 1.461-4(g)(2)-(7) (describing situations in which economic performance occurs).

63. *See* Treas. Reg. § 1.451-1(a) ("Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless [taxpayer uses the accrual method].").

64. *See id.* § 1.461-1(a)(1) ("Under the cash receipts and disbursements method of accounting, amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid.").

moving money from one pocket to another (and doing so only on paper), the couple generates a tax loss on Spouse *A*'s return without generating any offsetting income on Spouse *B*'s return. This tax loss can then be used to offset other income on Spouse *A*'s return. Creation of the loss need not involve any real expense to the couple; the loss is simply an artifact of the difference in accounting methods used by the two spouses.

The foregoing technique is unlikely to be interesting to single taxpayers. When an accrual method single taxpayer obligates herself to make a deductible deferred payment to an unrelated person, she is not merely moving money from one pocket to another; she is incurring an obligation that will someday have to be paid. The resulting tax loss is nice, but at most is worth only about 40% of the cash she will someday have to pay. When two unrelated taxpayers engage in such transactions, therefore, we can generally assume that the economic dog will wag the tax tail—as it should.

Heterosexual married couples are likely to find abuse of the technique more attractive. If they pool income, losses, assets, and liabilities, the technique merely involves a paper transfer from one to the other. Section 267(a)(2) tells us, however, that if such a transaction occurs between "persons specified in any of the paragraphs of subsection (b)," the transferor cannot take the deduction until the transferee recognizes the corresponding income.[65] "Spouses" are among the persons specified in that subsection (b).[66] This means that Spouse *A* can only take the deduction if and when Spouse *B* recognizes an equal amount of income. Section 267(a)(2) therefore effectively disallows use of this technique by heterosexual married couples to create artificial tax losses.

Because of DOMA, however, gay spouses, even if legally married as a matter of nontax law, are not "persons specified in any of the paragraphs of subsection (b)."[67] They are therefore not subject to Section 267(a)(2). As a result, the above-described technique remains open to them. Indeed, gay couples whose financial affairs are structured to take advantage of this and similar techniques should be able to generate significant artificial tax losses at will.

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65. *See* I.R.C. § 267(a)(2) (matching deduction and payee income item in the case of expenses and interest).

66. *Id.* § 267(b) (defining relationships).

67. *Id.*

D. Claiming Child Care Credits for Intra-Family Payments

Section 267(a)(2), discussed above, is only one of many provisions that disallow deductions or credits for payments within families. Another particularly troubling or delightful (depending on one's perspective) tax-minimization technique takes advantage of the omission of gay marriage from yet another such rule: Section 21. Section 21 authorizes a credit of between 20% and 35% of the cost of household and dependent care services necessary for gainful employment to taxpayers with one or more "qualifying individuals," the most common category of which is dependents who have not attained age thirteen.[68] Typically, mom wants to work, but will have to incur expenses for the care of her young children to do so. Section 21 reduces the net cost of her child care by up to 35%.

Here is the technique. Spouse *A* hires Spouse *B* to care for their children under age thirteen. The resulting payments will not be deductible to Spouse *A*, although they will constitute income to Spouse *B*. They will also likely trigger employment tax obligations (currently totaling 15.3%) with respect to Spouse *B*'s wages. Nevertheless, the value of a 20% to 35% credit may exceed any resulting income or employment tax costs. In addition, employment taxes paid with respect to Spouse *B*'s wages will be credited towards her eligibility for future Social Security benefits, the discounted value of which, as a matter of current law, are likely to exceed the value of her contributions. Finally, as discussed in Part III.B below, Spouse *B*'s earnings may qualify her for an earned income tax credit equal to up to 40% of those same earnings.

Unfortunately for heterosexual married couples, the Section 21 credit is not allowed for payments to one's spouse.[69] In addition, to qualify for that credit, the expenses must be incurred to enable both taxpayer and taxpayer's spouse to work or look for work;[70] the credit is not available if taxpayer's spouse stays home to take care of the children.[71] In addition, the amount of any employment-related expenses taken into account in computing the credit is limited to the lesser of taxpayer's and taxpayer's spouse's earned income.[72]

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68. *See id.* § 21(b)(1)(A) (defining a qualified individual).

69. *See* INTERNAL REVENUE SERV., PUBL'N 503: CHILD AND DEPENDENT CARE EXPENSES FOR USE IN PREPARING 2006 RETURNS 7 (2006) ("However, do not count any amounts you pay to . . . [y]our spouse . . . .").

70. *Id.* at 5; *see* I.R.C. § 21(d)(2) (2002 & West Supp. 2008) (deeming a spouse to be gainfully employed if she is a full-time student or is physically or mentally incapable of caring for herself).

71. *See* Allan J. Samansky, *Child Care Expenses and the Income Tax*, 50 FLA. L. REV. 245, 246 (1998) (citing complaints that the credit discriminates against stay-at-home moms).

72. *See* I.R.C. § 21(d)(1)(B) (describing how the lesser of either an individual's earned

The credit is further limited for heterosexual married couples by the fact that it is only available if they file jointly[73]—as a result of which the income phase-outs used in computing the credit will necessarily depend on their joint incomes.

Gay spouses, however, are not "spouses" for purposes of any of these prophylactic rules. As a result, the arrangement described above should be given full tax effect. Spouse *A* should be eligible for the Section 21 credit. Spouse *B* should report the payments made by Spouse *A* to care for their children as income. While this may trigger employment and income taxes, it may also qualify Spouse *B* for the earned income tax credit, as discussed further in Part III.B below, while boosting her eligibility for future Social Security benefits. There are many gay couples for whom such an arrangement would likely be financially attractive.

E. Corporate and Other Business Tax Abuse Possibilities

The wholly-owned corporation opens the door to yet another world of potential tax abuse, unfettered by responsibilities to minority shareholders. Existing anti-abuse rules, perfected in response to decades of taxpayer experimentation, have been relatively effective at keeping this door shut in the context of heterosexual marriage. Spouses might attempt to circumvent the rules by splitting ownership of a wholly-owned corporation fifty–fifty.[74] Under Sections 267[75] and 318,[76] however, each heterosexual spouse is deemed to own any stock actually owned by the other.[77] A corporation is then treated as related to an individual for Section 267 purposes if the individual actually or constructively owns *more than 50%* of the corporation's stock;[78] for Section 318 purposes, the corporation is treated as related to an individual if the individual actually or constructively owns *50% or more* of the corporation's stock.[79] Taken together, these attribution rules ensure that a business wholly-

income or the earned income of his spouse provides the earned income limitation).

73. *Id.* § 21(e)(2).

74. If necessary, they can also vest ownership of some portion of the corporation's stock in one or more of their children.

75. *See* I.R.C. § 267 (dealing with transactions between related taxpayers).

76. *See id.* § 318 (dealing with constructive ownership of stock).

77. Stock owned by the children is also attributed back to their parents.

78. *See* I.R.C. § 267 (2002 & West Supp. 2008) (dealing with transactions between related taxpayers).

79. *See id.* § 318 (dealing with constructive ownership of stock).

owned, or effectively wholly-owned, by a heterosexual married couple will in fact be treated as such and will be treated as related to both spouses for most related-party anti-abuse rule purposes.

Because gay spouses are not "spouses" within the meaning of the Code, however, the Section 267 and Section 318 inter-spousal attribution rules do not apply.[80] This, in turn, means that it should be possible for gay spouses to structure their stockholdings so as to avoid being treated as related to the family's majority or wholly-owned corporation. For Section 267 purposes, they need only split their holdings fifty–fifty.[81] For Section 318 purposes, they can give a small number of shares to an unrelated third party and hold the rest fifty–fifty.[82] One spouse's shares will not be attributed to the other. Neither spouse's percentage interest will rise, by itself, to the requisite 50% level, and the corporation will remain unrelated to either for most federal income tax purposes.

Many of the avoidance techniques discussed in this Part II can then be undertaken between a spouse and the family corporation. The corporation can buy property from the spouse, or the spouse from the corporation, in exchange for an installment obligation; the buyer can then resell to the outside world for cash; and the family group can defer the resulting gain until the installment obligation is paid.[83] The corporation can buy a spouse's debt from a third-party creditor at a discount, or the spouse can do the same for the corporation, without triggering debt discharge income.[84] An accrual method corporation can incur a deductible deferred obligation to one of the spouses for goods or services, which that cash method spouse will then not have to report until payment is made.[85] Indeed, if the corporation hires both spouses to perform services on a deferred payment basis, it may be able to deduct the resulting unpaid salaries currently, offsetting the corporation's outside income; no one owes tax on the accrued salaries until they are actually paid.

The foregoing possibilities, however, do not even begin to touch on the core anti-abuse functions played by Section 318. An exploration of the impact

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80. In addition, state law often does not allow one gay spouse to attain formal parent status vis-à-vis a child of the other whom she nevertheless views as emotionally her own. As a result, one of the two gay spouses will often not qualify as a "parent" of one or more of the family's children for federal tax purposes. *See supra* note 37 (recognizing the legal status of LGBT families).

81. *See* I.R.C. § 267 (dealing with transactions between related taxpayers).

82. *See id.* § 318 (dealing with constructive ownership of stock).

83. *See supra* Part II.A (deferring recognition of gain on a sale of property for cash).

84. *See supra* Part II.B (avoiding recognition of debt discharge income).

85. *See supra* Part II.C (explaining how gay couples can create lawful artificial tax losses to offset unrelated income on tax returns).

of my thesis on the corporate tax rules is beyond the scope of this Article. Preliminary analysis, however, suggests that significant parts of Subchapters C and S, the Code's corporate tax subchapters, may effectively collapse in the context of gay marriage.

Consider, for example, the following. In general, corporate distributions are treated as dividends taxable at ordinary rates[86]—although current law provides that qualified dividend income is to be taxed at capital gains rates through 2010.[87] Notwithstanding this general rule, Section 302(b)(2) provides that a stock redemption that reduces a shareholder's interest by more than 20%—a so-called "disproportionate redemption"—will generally be given sale rather than dividend treatment.[88] If so, the redeemed shareholder recognizes gain equal to the amount by which the distribution exceeds taxpayer's basis in the redeemed stock; any such gain is taxable only at capital gains rates even after 2010.[89] Now assume that a married couple owns all of a corporation's stock. Enough of Spouse *A*'s stock is redeemed to qualify for sale treatment under 302(b)(2). The couple still owns 100% of the corporation; nevertheless, unless Section 318 applies, Spouse *A* will qualify for sale treatment. To counter this potential abuse, Section 318 attributes heterosexual Spouse *B*'s holdings to Spouse *A*.[90] As a result, Spouse *A* is deemed to own 100% of the corporation both before and after the distribution. She has therefore not experienced the requisite disproportionate redemption, Section 302(b)(2) is inapplicable, and the entire amount of the distribution remains taxable as a dividend.[91]

But gay spouses are not "spouses" for purposes of Section 318. Spouse *B*'s stock is therefore not treated as owned by Spouse *A* for any purpose. Because DOMA excludes gay marriage from the operation of Section 318,[92] Spouse *A* may withdraw cash from the family's wholly-owned corporation

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86. *See* I.R.C. § 316(a) (2002 & West Supp. 2008) ("[T]he term 'dividend' means any distribution of property made by a corporation to its shareholders . . . out of its earnings and profits accumulated after February 28, 1913, or . . . out of its earnings and profits of the taxable year . . . .").

87. *Id.* § 1(h)(11); *see also* Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222, 120 Stat. 345, 346 (codified at scattered sections of 26 U.S.C.) (extending the capital gains and dividend tax rates set to expire in 2008 through 2010).

88. I.R.C. § 302(b)(2).

89. *Id.*

90. *See id.* § 318(a)(1) (attributing stock ownership to spouses and other family members).

91. *Id.* § 1(h)(11).

92. *See* 1 U.S.C. § 7 (2000) (declaring the word "spouse" applies only to a person of the opposite sex who is a husband or wife).

without ever being required to report the withdrawal as a dividend. She need only report her gain or loss, if any, on the deemed sale. To the extent that she lacks adequate basis in her stock to prevent recognition of gain, another simple technique can be used to increase that basis: Spouse *A* first loans Spouse *B* the requisite amount. Spouse *A* then contributes Spouse *B*'s obligation to the corporation. Because she has basis in Spouse *B*'s obligation, she receives an equivalent basis increase in her stock. The corporation can then undertake the Section 302(b)(2) distribution without triggering any tax liability whatsoever to any party.

The foregoing is merely illustrative. Numerous other techniques for circumvention of the policies of Subchapters C and S undoubtedly exist. Similar problems also likely pervade Subchapter K, the partnership tax subchapter; Section 707(b)(3), the partnership tax attribution rule, cross-references Section 267, which, as we have already seen, treats gay spouses as unrelated for all purposes.[93]

The underlying problem is simple: Gay spouses commonly pool their finances. Like heterosexual married couples, they may be relatively indifferent to whether a particular item is received in or paid out of one pocket rather than another. In other words, in gay marriage, as in heterosexual marriage, the assumption of selfishness commonly fails. When it does, the tax tail can wag the economic dog just as easily in gay marriage as it can in heterosexual marriage. Committed gay spouses, treated as single by the Code, may be perfectly happy to undertake tax-motivated transactions that truly single taxpayers would find economically unattractive. We, in turn, are likely to find such transactions no less offensive when undertaken by gay couples than they would be if undertaken by heterosexual married couples. And this is true even if we object to gay marriage itself for nontax reasons.

III. Related-Party Rules Limited to Marriage

My goal in Part II above is modest: To establish the credibility of my thesis in a range of relatively simple contexts. In each such context, Part II demonstrates that (1) the basic rules of the Code assume that taxpayers are truly unaffiliated; (2) when this assumption of selfishness fails, as in heterosexual marriage, special related-party rules are needed to contain the resulting potential abuse; and (3) when the assumption of selfishness fails and such special related-party rules explicitly do not apply, as in gay marriage, we are

93. *See supra* Part II.C. (explaining that, under I.R.C. § 267, constructive ownership of stock is extended to certain related persons, but not to gay spouses).

likely to perceive the results as tax-abusive—not merely as singles doing what singles do.

In Part III, I turn to related-party rules limited to marriage—long the province of "taxable unit" or "marriage penalty" analysis. Here, the analytic thickets become significantly more entangled. Nevertheless, in this context I propose to make the same demonstration: that (1) the basic rules assume that taxpayers are unaffiliated; (2) when this assumption fails, special rules are needed to contain the resulting potential abuse; and (3) when the assumption of selfishness fails and such special rules explicitly do not apply, as in gay marriage, we are likely to perceive the results as tax-abusive. My purpose in this Part, however, is more ambitious—to establish the breadth and power of my thesis and show that it permits a methodologically uniform analysis of a much broader range of related-party issues than any competing theoretical approach. I begin with income-splitting, joint return filing, and the "marriage penalty." If the "taxable unit" and "marriage penalty" approaches should have any explanatory power, it should be in the analysis of rates applicable to married couples.

A. Income-Splitting to Reduce Effective Progressive Tax Rates

1. Joint Return Filing as an Anti-Abuse Measure

In a progressive rate environment, splitting a single stream of income into two separately taxable streams is often advantageous.[94] A simple example illustrates why. Assume the following rate structure:

Income	**Rate**
First $10,000	0%
Remainder	30%

Assume that *H* earns $30,000 of taxable income per year. If he is single and unattached, his income tax liability will therefore be $6,000 (0% of $10,000 plus 30% of $20,000). If, however, he has made a long-term commitment to *W*, he may be willing to assign half his income to her. If he does so, and if we give tax effect to that assignment, each will have taxable income of $15,000 and face a tax liability of $1,500 (0% of $10,000 plus 30%

94. I.R.C. § 1561 (2002 & West Supp. 2008) effectively disallows income-splitting through use of a controlled group of corporations. *Id.* I.R.C. § 11(b)(2) similarly disallows income-splitting through use of qualified personal service corporations. *Id.*

of $5,000). By splitting *H*'s income between the two of them, *H* and *W* cut their total federal income tax liability in half—from $6,000 to $3,000. This tax-saving technique, of course, is limited to situations in which *H* and *W* are willing to pool their resources. Self-interested, unaffiliated taxpayers will typically not transfer half their income to someone else solely to reduce their taxes. In other words, income-splitting is only plausible as a tax-saving technique in relationships in which there is a major failure of the assumption of selfishness.

The benefits of income-splitting became obvious to married taxpayers shortly after the modern U.S. income tax was introduced in 1913. One very simple income-splitting technique came before the Supreme Court in 1930 in *Lucas v. Earl*.[95] By contract, husband and wife had each assigned half of his or her income to the other.[96] As was typical of the era, only the husband worked outside the home.[97] At the time, married taxpayers filed individual returns. Consistent with their contract, husband and wife each reported half of husband's personal services income on his or her individual return, thereby claiming the rate advantages of income-splitting.[98] The Court sustained the government's challenge to this device, holding that since husband had earned it, the couple's income should be taxed to him.[99]

Later that year, a similar issue came before the Court in *Poe v. Seaborn*.[100] This time, however, income-splitting was effected by state community property rules.[101] In Washington State, as a matter of law, each spouse owned half the personal service income earned by either during the marriage.[102] In addition, the wife in question was deemed to own half the couple's income-producing property and therefore half the income from that property.[103] Because half the

95. *See* Lucas v. Earl, 281 U.S. 111, 114–15 (1930) (holding that a husband's entire salary was taxable to him, despite a contractual arrangement that any property acquired by the couple would be held as a joint tenancy).

96. *Id.* at 113–14.

97. See Bureau of Labor Statistics, Employment Status of the Civilian Population by Sex and Age, http://stats.bls.gov/webapps/legacy/cpsatab1.htm (last visited Sept. 15, 2008) (on file with the Washington and Lee Law Review), for historical information on workforce participation. In 1948, the workforce participation rate for women twenty years and older was 31.8%, compared to 88.6% for men in the same age group. *Id.*

98. *Lucas*, 281 U.S. at 113.

99. *Id.* at 115.

100. *See* Poe v. Seaborn, 282 U.S. 101, 118 (1930) (holding that where state community property laws mandated that half of a married couple's property belonged to the wife, each spouse could file separate federal income tax returns claiming half the community as their own).

101. *Id.* at 109.

102. *Id.* at 110–11.

103. *Id.* at 113.

couple's income belonged to the wife as a matter of mandatory state property law, not merely as a matter of voluntary contractual assignment, the Court held that her half was properly taxable to her.[104] The effect of *Seaborn* and its progeny[105] was to make income-splitting automatic in states with mandatory community property laws and thereby reduce dramatically the effective rates of federal income tax imposed on married couples in such states. Couples in common law states continued to pay substantially more. As a result, common law states faced intense political pressure to adopt community property regimes, and some did.[106]

In 1948, Congress resolved this problem by authorizing the filing of joint returns. Under the new joint-return regime, married couples were invited to pool their income and deductions for federal income tax purposes.[107] If they did so, then whether the pooled items belonged to husband or wife—and therefore whether the couple lived in a community property or common law state—became irrelevant.[108] Special rates applied to the couple's pooled net income, thus reported. Married couples who declined this invitation were subject to a special set of rates applicable only to married individuals filing separately.[109] These married-filing-separately rates were almost always less favorable than the rates imposed if the couple filed jointly.[110] As a result, although joint filing was optional, most married couples took advantage of Congress's invitation.

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104. *Id.* at 118.

105. *See* United States v. Malcolm, 282 U.S. 792, 794 (1931) (applying *Seaborn* to California's community property laws); Bender v. Pfaff, 282 U.S. 127, 130 (1930) (applying *Seaborn* to Louisiana's community property laws); Hopkins v. Bacon, 282 U.S. 122, 125 (1930) (applying *Seaborn* to Texas's community property laws); Goodell v. Koch, 282 U.S. 118, 120 (1930) (applying *Seaborn* to Arizona's community property laws). *But see* Comm'r v. Harmon, 323 U.S. 44, 46–47 (1944) (declining to apply *Seaborn* to Oklahoma's community property laws on the ground that they were elective).

106. *See generally* Jennifer E. Sturiale, *The Passage Of Community Property Laws, 1939–1947: Was "More Than Money" Involved?*, 11 MICH. J. GENDER & L. 213 (2005).

107. *See* Revenue Act of 1948 §§ 301–303, Pub. L. No. 80-471, 62 Stat. 110, 114–16, *repealed by* Tax Reform Act of 1969, Pub. L. No. 91-172, § 803, 83 Stat. 487, 678–79 (allowing spouses to file jointly, incurring the same tax liability as two single persons, each with half the couple's income) (codified as amended in scattered sections of 26 U.S.C.).

108. *See* S. REP. No. 80-1013 (1948), *as reprinted in* 1948 U.S.C.C.A.N. 1163, 1184–87 (stating that one purpose of the Revenue Act of 1948 was to create geographic equalization in tax treatment between common law and community property states).

109. *See* EDWARD J. MCCAFFERY, TAXING WOMEN 15–16 (University of Chicago Press 1997) (describing the advantages of filing jointly to married couple under the rate schedules established by the Revenue Act of 1948).

110. *Id.*

Joint-return filing thus originated as an anti-abuse measure, not as the result of an effort to identify some theoretically proper "taxable unit." Although Congress's 1948 authorization of the joint return system was prompted by the Supreme Court's decision to respect community property rules, the underlying problem was that of income-splitting. Income-splitting remains possible without either community property rules or *Seaborn*. *Lucas v. Earl* tells us that a mere contractual splitting of income will not be given tax effect; other techniques, however, undoubtedly will. The simplest approach—completely unassailable—is for two spouses to get jobs that pay roughly equal amounts. Income from property can be split equally by making ownership of the underlying property equal—which community property rules accomplish as a matter of law. In many situations, even income earned from the sale of a single spouse's services can be split without running afoul of *Lucas v. Earl*. Assume, for example, that Spouse *A* operates a service business.[111] The business is dropped into a jointly-owned pass-through entity (a partnership or S corporation), Spouse *A* is employed to provide the services the entity will now sell, Spouse *B* is employed to manage the business, their salaries are equalized at defensible levels, and each spouse is given 50% ownership of the entity. Bingo! Perfect income-splitting without community property rules or *Seaborn*. More complex and therefore difficult-to-challenge structures can also be devised.

Truly single taxpayers will not income-split merely to reduce taxes; to do so they must give up more income than they will save in taxes. Heterosexual married couples who pool their finances typically find income-splitting unobjectionable, but the joint return rules to which they are subject make income-splitting fruitless. Gay couples who pool their finances, however, are not subject to the joint return rules or the punitive married-filing-separately rates that effectively force most heterosexual married couples into a joint return posture. They can therefore income-split and, in a progressive rate environment, benefit from doing so.

As a result, income-splitting gay spouses will often pay lower taxes than comparable single taxpayers, gay or straight. Consider *X* and *Y*, each of whom earns $60,000 of taxable income. *X* is single; based on the 2007 rate tables she therefore owes $11,424 of U.S. income tax. *Y*, although "single" for federal tax purposes, is in fact married and splits her income with her same-sex spouse;

111. *See* Scott A. Hodge, *Countdown to Tax Reform, Part V: High-Income Taxpayers and the Entrepreneurial Class*, http://www.taxfoundation.org/publications/show/1134.html (last visited Oct. 3, 2008) (describing a recent study by the Tax Foundation which concludes that 43% of taxpayers in the top 20% by income, and almost three-quarters in the top 1%, have business income) (on file with the Washington and Lee Law Review).

each reports $30,000 of taxable income. Based on the 2007 rate tables, they therefore owe a total of $8,218 of U.S. income tax. Because *Y* can income-split and *X* cannot, *X* owes *almost 40% more tax* than *Y* and her spouse on the same $60,000 of taxable income.

But how are income-splitting gay couples taxed relative to married heterosexual couples? There is one further topic we must explore before we can answer this question—the relationship between joint return and single rates. To this topic I now turn.

2. *"Marriage Bonuses" and "Marriage Penalties"*

Joint return filing creates a new issue: At what rates should Congress tax joint return filers? Unfortunately, this is a more difficult question than might first appear. Assume that the rate structure with which I began this Part III.A is the rate structure for single taxpayers:

Income	Rate
First $10,000	0%
Remainder	30%

Assume further that our task is to construct a rate structure for married taxpayers filing jointly that approximates this rate structure for singles.

One possibility would be to hypothesize two identically situated single taxpayers, both working, and compute joint return rates that exactly *double the tax that would be imposed on each separately*. I call this the "two-earner endpoint" because it (1) mimics the tax at single taxpayer rates that would otherwise be imposed on two equal-earning taxpayers and (2) constitutes one endpoint of a range of plausible solutions to the joint return rate-setting problem. We know we are at the two-earner endpoint if our joint return rate structure simply *doubles the single-rate bracket boundaries*. Applying this procedure to the foregoing rate structure for single taxpayers, at the two-earner endpoint we double the bracket boundary from $10,000 to $20,000:

Income	Rate
First $20,000	0%
Remainder	30%

Note the consequences of this solution. Assume that before they marry, *H* and *W* each earn $30,000 of taxable income. Single, each therefore owes $6,000 in taxes (0% of $10,000 plus 30% of $20,000). If we impose joint return rates at the two-earner endpoint, *H* and *W*, married and filing jointly, report combined taxable income of $60,000 and owe $12,000 in taxes (0% of $20,000 plus 30% of $40,000)—exactly what they owed unmarried.

Now consider a more traditional couple, also earning a total of $60,000. *H*, however, earns the entire amount. Before he marries, applying the single rate schedule given above, *H* owes $15,000 in taxes (0% of $10,000 plus 30% of $50,000). Once he marries, he gets the benefit of the joint return rates we derived in the preceding two paragraphs; the couple therefore owes the same $12,000 as its less traditional counterpart, which also earns a total of $60,000. In tax parlance, this is known as "couples neutrality"; if joint return rate structures are "couples neutral," couples earning the same amount pay the same amount in taxes.[112] Preservation of couples neutrality was one of Congress's goals in authorizing joint return filing in the first place.[113] But note that because of couples neutrality, *H* now gets a "marriage bonus" of $3,000 per year. Indeed, if we set joint return rates at the two-earner endpoint, single-earner couples almost always get a marriage bonus—a federal income tax cut by reason of getting married.[114]

The reason is simple: Setting joint return rates at the two-earner endpoint is mathematically equivalent to giving joint return-filing married couples in every state the benefits of de jure income-splitting. If our traditional couple had successfully split *H*'s $60,000 of income, *H* and his wife would each have reported $30,000 of taxable income and would therefore have placed themselves in a tax posture identical to that of their two-earner counterparts. When Congress authorized joint return rates at the two-earner endpoint in 1948, it effectively extended the income-splitting benefits of *Seaborn* to all U.S. married couples, regardless of state law.

At first blush, creation of a marriage bonus might seem unobjectionable, at least to those who think marriage is something to be encouraged. But if married taxpayers are automatically granted the benefits of a circumvention technique—here, income-splitting—not available to singles, then at comparable

112. *See* Zelenak, *supra* note 10, at 4 (defining couples neutrality).

113. *See* Frederick J. Bradshaw IV, *The Earned Income Tax Credit and the Marriage Penalty: New Proposals in Light of the Economic Growth and Reconciliation Act of 2001*, 54 TAX LAW. 701, 717 (2001) ("The 1948 Act's joint return provision manifested Congress'[s] preference for progressivity and couples neutrality at the expense of marriage neutrality.").

114. *See* Wendy Richards, *An Analysis of Recent Tax Reforms From a Marriage-Bias Perspective: It is Time to Oust Marriage From the Tax Code*, 2008 WIS. L. REV. 611, 621–22 (describing how joint-filing brackets twice as large as the single-filing brackets create an economic windfall for single-earner families by allowing them to earn twice as much and stay in the lower bracket).

income levels married taxpayers will likely pay lower average federal income taxes than single taxpayers. When joint return rates are set at the two-earner endpoint, therefore, the federal income tax becomes, in effect, a system for transferring wealth from America's unmarried to its married taxpayers.

Perhaps we could solve this problem by setting our married-filing-jointly rates to replicate the taxes the more traditional couple would have paid had they not married. I call this solution the "single-earner endpoint." Recall that before marrying *W*, traditional *H* owed $15,000 of taxes on his $60,000 of income. If we want to avoid giving him a marriage bonus, we simply set joint return rates at the single-earner endpoint. At that endpoint, our joint return bracket boundaries are *the same as the bracket boundaries applicable to singles*:

Income	**Rate**
First $10,000	0%
Remainder	30%

At the single-earner endpoint, traditional *H* incurs no tax bonus or penalty from marrying. Single or married, he owes $15,000 in federal income tax. But consider the plight of the two-earner couple, each earning $30,000. Before marrying, they paid a total of $12,000 in federal income tax. Married, under a joint return rate schedule set at the single-earner endpoint, they owe $15,000. The $3,000 rate bump they face by reason of marriage is what we conventionally call their "marriage penalty."[115]

Many would prefer a joint return rate structure that satisfies three criteria: (1) it would be progressive (the example given above involves a flat tax with an initial exempted amount,[116] which is progressive enough to create the problem), (2) it would not impose any marriage penalty or grant any marriage bonus ("marriage neutrality"), and (3) couples with equal amounts of income would be taxed equally ("couples neutrality"). Unfortunately, it is mathematically impossible to satisfy all three criteria simultaneously.

> A truly flat tax (with no exemption amount or zero bracket) can achieve couples neutrality and marriage neutrality at the sacrifice of progressivity. A separate return system can have progressive rates and marriage

115. *See* Zelenak, *supra* note 10, at 7 (defining marriage penalties and outlining their sources).

116. Every so-called "flat tax" that has been seriously considered by Congress has provided for such an exemption. *See, e.g.*, M. Scotland Morris, *Reframing the Flat Tax Debate: Three Not-So-Easy Steps For Evaluating Radical Tax Reform Proposals*, 48 FLA. L. REV. 159, 166–72 (1996) (discussing different aspects of the Hall-Robushka, Armey, Forbes, and Specter flat tax plans, including the common element of a personal exemption).

> neutrality, at the sacrifice of couples neutrality. But if progressive marginal rates and couples neutrality are required, there must be marriage penalties, marriage bonuses, or both.[117]

Since 1969, therefore, Congress has compromised, setting the rates for joint returns somewhere between the two endpoints. Currently, joint return regular tax rates are set at the two-earner endpoint at lower income ranges but drift towards the single-earner endpoint at higher income ranges.[118] The consequence is that upper-income heterosexual couples in which both spouses work commonly face marriage penalties in the regular tax while more traditional heterosexual couples almost always receive marriage bonuses.[119]

Gay spouses, of course, are not "spouses" for federal tax purposes. As a technical matter, therefore, "traditional" gay couples—by which I mean gay couples in which one spouse is the sole breadwinner—do not receive marriage bonuses, and gay couples in which both spouses work do not face marriage penalties. Gay couples can, however, income-split. If they do, they are taxed at the equivalent of the two-earner endpoint. (Remember that at the two-earner endpoint, heterosexual married couples are taxed as if they were single taxpayers engaged in perfect income-splitting.) Income-splitting gay couples, including California registered domestic partners if *Seaborn* applies, therefore obtain the equivalent of the marriage bonus heterosexual couples would receive if all joint return rates were set at the two-earner endpoint—an even bigger "marriage bonus" than upper-income heterosexual couples actually receive under current law. And gay couples are never ever subject to marriage penalties.

An example based on 2007 federal rates[120] illustrates this advantage. Assume a couple with $350,000 of taxable income; to make things simple, assume that the couple has no itemized deductions. If the spouses are straight and married, they owe total federal income tax of $101,574. If they are income-splitting gays, they owe total federal income tax of only $87,637—*$13,983 per year less than their heterosexual married counterparts.*[121] This tax disparity between heterosexual and

117. Zelenak, *supra* note 10, at 6–7.

118. *See* Rev. Proc. 2006-53, 2006-48 I.R.B. 996 Sec. 3.01 (establishing the regular tax rates for individuals and couples filing jointly for 2007).

119. *See infra* Part III.A.3 (explaining how the shift toward the single-earner endpoint at higher income levels in the regular tax rates creates marriage bonuses for heterosexual married couples with only one income, while creating marriage penalties for two-income heterosexual married couples at all but the lowest income levels).

120. Rev. Proc. 2006-53, *supra* note 118, Sec. 3.01.

121. The computations reported in text take into account the phase-out of personal exemptions required by I.R.C. § 151(d)(3). *See* I.R.C. § 151(d)(3) (2002 & West Supp. 2008) (providing for a two percentage point reduction of the exemption amount for every $2,500 by which the taxpayer's AGI exceeds the threshold amount).

income-splitting gay couples varies with income. As the couples' income declines, the income-splitting gay couple's advantage over their heterosexual married counterparts declines as well, disappearing entirely when their taxable income reaches $128,500, reflecting the current partial abolition of the "marriage penalty" at lower income levels.[122]

Ironically, the only way a heterosexual couple can do as well is by getting divorced while continuing to live together in a financially-intermingled relationship. As tax lawyers develop more effective income-splitting techniques for their married gay clients, divorce (or, more likely, long-term commitment without marriage) is likely to become an increasingly attractive option for heterosexuals.

3. *Expanding the Concept of "Marriage Penalties"*

The "marriage penalty" problem, however, is more extensive than conventional marriage penalty theory sometimes suggests. As the foregoing analysis indicates, there is an easy way to identify marriage penalties at sight: *A marriage penalty exists whenever any income or expense cut-off figure for married couples filing jointly is less than twice the corresponding figure for single taxpayers*—in other words, any time such a cut-off is set at anywhere other than the two-earner endpoint of the plausible range. Viewed from this perspective, the Code is chock-full of marriage penalties. Let us start with the 2007 regular tax tables[123] (dollar figures represent taxable income):

Single Rate Boundary	Married Filing Jointly Rate Boundary	Rate Below Boundary
$7,825	$15,650 (=2.00 x)	10%
$31,850	$63,700 (=2.00 x)	15%
$77,100	$128,500 (=1.67 x)	25%
$160,850	$195,850 (=1.22 x)	28%
$349,700	$349,700 (=1.00 x)	33%
Taxable income above the 33% rate boundary		35%

122. *Seaborn* also creates a potential disparity between the taxation of gay couples in California and gay couples in states that do not impose mandatory community property rules on gays—currently all other states. If Spouse *A* earns the entire $300,000 of taxable income and Spouse *B* none, a gay couple in any other state will pay $87,649 in federal income taxes on the same income—$15,640 (almost 22%) more *per year* than their California counterparts. This differential, however, is eliminated to the extent that the non-California gay couple income-splits. These computations assume that Spouse *B* qualifies as a dependent of Spouse *A*. *See supra* note 34 (defining "dependent"). If she does not, the disparity is worse.

123. Rev. Proc. 2006-53, *supra* note 118, Sec. 3.01.

Note that the first two rate boundaries for married taxpayers filing jointly are exactly twice the corresponding rate boundaries for single taxpayers (thus, $15,650 is exactly two times $7,825). This eliminates any regular tax rate marriage penalty for couples with taxable income of less than $128,500.[124] At higher incomes, however, heterosexual married taxpayers still pay substantial regular tax rate penalties for being married. Indeed, the boundary between the 33% and 35% rates is actually set at the single-earner endpoint—the worst possible solution for heterosexual married taxpayers. Income-splitting gay couples pay no such penalties.

In addition to regular tax, all taxpayers are potentially liable for alternative minimum tax ("AMT"), defined as the excess of a taxpayer's tentative minimum tax over her regular tax for the year.[125] The corresponding 2007 tentative minimum tax rate tables, taking phase-outs into account,[126] are even worse for heterosexual married couples than the regular tax tables (dollar figures represent alternative minimum taxable income ("AMTI")):

Single Rate Boundary	**Married Filing Jointly Rate Boundary**	**Rate Below Boundary**
$42,500	$62,550 (=1.47 x)	0%
$112,500	$150,000 (=1.33 x)	26%
$217,500	$237,550 (=1.09 x)	32.5%
$282,500	$400,200 (=1.42 x)	35%
AMTI above the 35% rate boundary		28%

Here, the boundary between the 26% and 32.5% rates is set just above the single-earner endpoint—a lower rate boundary with larger percentage consequences. The remaining cut-offs for jointly-filing married taxpayers are all substantially less than twice the corresponding cut-offs for single taxpayers. We should therefore expect that gay couples who income-split should generally be subject to tentative minimum tax at much lower effective rates than their heterosexual married counterparts. The only point at which the fact that the married-filing-jointly rates are set closer to the single-earner endpoint helps heterosexual couples is at the final rate boundary, the boundary between the 35% rate imposed on joint income up to $400,200 and the 28% rate imposed on joint income in excess of that amount.

124. $14,600 + $44,800 + $60,550 = $119,950.

125. *See* I.R.C. § 55(a) (2002 & West Supp. 2008) (defining Alternative Minimum Tax).

126. *See id.* § 55(b)(1)(A)(i) (setting out rates imposed on taxable excess); *id.* § 55(b)(1)(A)(ii) (defining taxable excess); *id.* § 55(d)(1) (setting noncorporate exemption amount); *id.* § 55(d)(3) (establishing phase-out of exemption amounts).

Again, a numerical example may be helpful. Assume a couple with $300,000 of 2007 AMTI. If the partners are heterosexual and married, they owe tentative minimum tax of $73,028. If they are income-splitting gay spouses, they owe tentative minimum tax of only $60,775—*$12,273 per year* less than their heterosexual married counterparts. Ultimately, each couple is required to pay the greater of its tentative minimum tax liability and its regular tax liability each year. We cannot determine whether the tentative minimum tax disparity between heterosexual and gay couples will survive that comparison without knowing more about the nature of the couples' incomes and deductions. Nevertheless, the disparity is large enough to be troubling on its own.[127]

Although we conventionally use the phrase marriage penalty to refer only to rate issues,[128] the same problem arises on the deduction side—reflecting the fact that married couples do not merely income-split, they expense-split as well. Recall that a potential tax disadvantage by reason of marriage is imposed any time a cut-off figure for married couples is less than twice the corresponding figure for single taxpayers. Consider, in this light, the Section 68 "overall limitation on itemized deductions." Once a taxpayer's adjusted gross income ("AGI") exceeds a so-called "applicable amount" ($156,400 in 2007),[129] Section 68 begins to disallow some of the itemized deductions to which taxpayer would otherwise be entitled.[130] In 2007, a couple treated as unmarried—a legally-married gay couple, for example—can therefore receive up to $312,800 of AGI (that is, $156,400 each) without being subject to the Section 68 disallowance. Heterosexual married couples, by contrast, get only one such applicable amount; in 2007, their itemized deductions are phased out once their combined AGI's exceed $156,400.[131] Again, it pays to be gay. Similarly, the phase-out for personal exemptions begins for singles once AGI

127. *Seaborn*, if applicable, creates a potential disparity between the AMT taxation of gay couples in California and gay couples in other states. If Spouse *A* earns the entire $225,000 of AMTI and Spouse *B* none, a gay couple in any other state will pay $56,980 in federal income taxes on the same income—$19,410 (over 50%) more *per year* than their California counterparts. This differential is eliminated to the extent that the non-California gay couple income-splits.

128. *See* Zelenak, *supra* note 10, at 55 ("[T]he relationships among the standard deductions for joint returns, single filers, and heads of households create substantial marriage penalties for some taxpayers.").

129. *See* Rev. Proc. 2006-53, *supra* note 118, Sec. 3.12 (establishing the threshold AGI amount at which itemized deductions become disallowed).

130. *See* I.R.C. § 68(a) (2002 & West Supp. 2008) (establishing limitations on itemized deductions).

131. Rev. Proc. 2006-53, *supra* note 118, Sec. 3.12.

exceeds $156,400; income-splitting couples treated as single can therefore receive up to $312,800 of adjusted gross income ($156,400 each) before beginning to lose their personal exemptions.[132] Heterosexual married couples, however, begin to lose those same exemptions when their combined AGI's exceed $234,600.[133]

And the list goes on. Section 163(h)(3)(B) allows a deduction for home mortgage interest on the first $1,000,000 of acquisition indebtedness—married or single.[134] A gay couple buying a house jointly can therefore deduct interest on up to $2,000,000 ($1,000,000 each) of home mortgage indebtedness. Their heterosexual married counterparts may only deduct interest on the first $1,000,000 of such debt. Section 179 permits the 2007 expensing of $112,000 of qualified capital expenses—married or single.[135] Married gay couples can therefore currently deduct $224,000 of such expenses.

The same holds true for many credits. The Section 21 credit for household and dependent care services necessary for gainful employment, discussed in Part II.D above, begins to phase out when AGI exceeds $15,000—married or single.[136] For married gay couples who income-split, it only begins to phase out when their combined AGI exceeds $30,000.[137] The Section 24 child tax credit phase-out threshold is $75,000 for a single taxpayer and $110,000 for a married couple[138]—still less than twice the single taxpayer threshold. The Section 32 earned income credit begins to phase out when earned or adjusted gross income is just $2,000 more for married couples than for singles[139]—far less than twice the single taxpayer threshold. As a result, in each case, income-splitting gay couples can receive substantially greater tax credit assistance than identically-situated married heterosexuals.

4. *California Same-Sex Spouses,* Seaborn, *and Chief Counsel Advisory 200608038*

As of January 1, 2005, gay couples and older straight couples in California are eligible to register for a domestic partnership status that subjects them to

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132. *Id.* Sec. 3.18.

133. *Id.*

134. I.R.C. § 163(h)(3)(B)(ii).

135. Rev. Proc. 2006-53, *supra* note 118, Sec. 3.19.

136. I.R.C. § 21(a)(2) (2002 & West Supp. 2008).

137. *Id.*

138. *Id.* § 24(b)(2).

139. $3,000 for years after 2007. *Id.* § 32(b)(2)(B)(iii).

mandatory community property rules identical to those imposed on heterosexual married couples.[140] Whether senior heterosexual couples who so register are "married" for federal income tax purposes is an interesting question beyond the scope of this Article. DOMA, however, makes it clear that gay registered domestic partners are not.[141] As a result, gay couples who register as domestic partners in California split their incomes, expenses, assets, and liabilities de jure as a matter of state law and should therefore at least arguably receive the benefits of de jure income-splitting for tax purposes under *Seaborn*. They are not, however, subject to joint-return or married-filing-separately rates and are treated as single for all other federal income tax purposes. If *Seaborn* applies, this means that they receive the benefits of income, expense, property, and liability-splitting automatically, even if they do not affirmatively undertake splitting techniques.

In response to this change in California law, the IRS has issued Chief Counsel Advisory 200608038 ("CCA 200608038"), which asserts that "the Supreme Court's decision in *Poe v. Seaborn* does not extend to registered domestic partners" and that "an individual who is a registered domestic partner in California must report all of his or her income earned from the performance of his or her personal services."[142] Although ostensibly concluding that *Seaborn* is not applicable to registered domestic partners at all, the advisory appears to concede that *Seaborn*'s principles may nevertheless apply to income from property—and apparently to deductions and liabilities as well. I am skeptical of both the validity of CCA 200608038 and repeal of *Seaborn* as a solution to the income-splitting problem, but defer detailed discussion of those issues to Part IV.B.1 below.

As should be clear, however, the underlying problem is not really created by *Seaborn*. It is created rather by the couple's willingness to pool their financial resources; California law merely codifies this willingness. The rate advantage comes from the division of the couple's income stream into two approximately equal and separately taxable halves. Whether and how this may be accomplished in the absence of community property rules given tax effect by *Seaborn* depends on circumstances. And this, in turn, means that the income-splitting tax advantages of gay marriage are not limited to California

140. The California Supreme Court has since ruled that denial of marriage to same-sex couples is unconstitutional. *See supra* note 31 (citing *In re* Marriage Cases, 183 P.3d 384, 471 (Cal. 2008) (overturning California's same-sex marriage ban as unconstitutional)). On November 4, 2008, California voters overturned this holding by ratifying Proposition 8. *Id.*

141. *See* 1 U.S.C. § 7 (2000) (limiting the definition of the term "marriage" to include only opposite-sex couples for the purposes of interpreting federal statutes).

142. IRS CCA 200608038, 2006 WL 469500 (IRS CCA) (Feb. 23, 2006).

domiciliaries and cannot be eliminated merely by repealing *Seaborn* or holding it inapplicable. If gay couples in any state can and are willing to split their net income into two approximately equal streams, they will effectively be taxed as if *Seaborn* applies. Such techniques are also available to heterosexuals, but because of the joint return rules heterosexual married couples get no significant tax benefit from the resulting income-splitting. Under DOMA, gay couples do.

Similarly, married gay couples can continue to obtain the benefits of being treated as single for tax purposes in other contexts in which "marriage penalties," as more expansively defined above, exist. If *Seaborn* applies to deductions, for example, when a California gay spouse pays interest on her home mortgage, she and her spouse may deduct interest on up to $2,000,000 principal amount of such mortgage (compared with interest on up to only $1,000,000 principal amount for married heterosexuals). If *Seaborn* does not apply or the couple resides elsewhere, the simple solution is for each gay spouse to pay half; together they again can deduct interest on up to $2,000,000 principal amount of their home mortgage.

B. Claiming a Larger Earned Income Credit at Higher Income Levels

The unintended tax advantages of gay marriage are even more pronounced at the low-income end of the U.S. income tax system. Section 32 allows low-income working taxpayers an "earned income credit."[143] This credit now constitutes the federal government's largest anti-poverty program.[144] Unfortunately, the mechanics of Section 32 ignore the failure of the assumption of selfishness in gay marriage. As a result, gay couples are potentially entitled to much larger earned income credits than heterosexual married couples.

Computation of the credit is somewhat complex. The amount of the credit equals (1) the "credit percentage" times the individual's or married couple's earned income, (2) capped by his, her, or their "earned income amount."[145] The credit percentage and earned income amount, in turn, depend on how many qualifying children the individual or couple has (figures are for 2007):[146]

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143. The credit is "refundable," which means that taxpayers may claim it even if they do not owe enough tax to absorb the credit; in such event, they get cash back.

144. *See* Zelenak, *supra* note 27, at 301 (describing the growth and scale of the earned income tax credit).

145. I.R.C. § 32(a)(1) (2002 & West Supp. 2008).

146. Rev. Proc. 2006-53, *supra* note 118, Sec. 3.01.

Qualifying Children	Credit Percentage	Earned Income Amount
None	7.65%	up to $5,590
One	34.00%	up to $8,390
Two or More	40.00%	up to $11,790

A single mom with one child and $10,000 of earned income, for example, is entitled to an earned income credit of $3,400 (34% times $10,000 of earned income, but not to exceed $8,390). This credit is "refundable," by which we mean that taxpayer is entitled to receive that $3,400 from the federal government even if she otherwise owes no taxes.[147] What is critical for our purposes is that in the case of a married couple, the credit is capped by a single earned income amount (e.g., $8,390 for one child). In the case of a couple treated as unmarried—for example, a gay couple—each spouse's credit is capped by a separate earned income amount (e.g., $8,390 each if each has one child). Gay couples are therefore potentially entitled to up to *twice the earned income credit* of heterosexual married couples.

In addition, gay couples are potentially *entitled to the credit at higher income levels* than heterosexual married couples. The credit begins to phase out once the greater of the individual's or couple's earned income or adjusted gross income exceeds a threshold phase-out amount. In 2007, the threshold phase-out amounts for heterosexual married couples are $2,000 higher than they are for single taxpayers.[148] But under DOMA, a gay couple is treated as two single taxpayers and therefore can earn almost twice as much before the credits of either begin to phase out. The effective 2007 phase-out thresholds for heterosexual married couples and income-splitting gay couples are therefore as follows:[149]

Qualifying Children	Heterosexual Married Couple	Income-Splitting Gay Couple
None	$9,000	$14,000
One or More	$17,390	$30,780

147. *See* Zelenak, *supra* note 27, at 305 ("The EITC is a refundable credit; if the amount of the credit exceeds the claimant's precredit federal income tax liability, the claimant receives the excess amount as a transfer payment.").

148. Rev. Proc. 2006-53, *supra* note 118, Sec. 3.01.

149. *Id.*

As a result, in the case of a heterosexual married couple without children, the 2007 credit phases out at income levels between $9,000 and $14,590.[150] For an income-splitting gay couple without children, by contrast, the credit may not begin to phase out until the couple's income reaches $13,060 and may not finish phasing out until that income reaches $23,500.[151] In the case of a heterosexual married couple with children, the 2007 credit phases out at income levels between $17,390 and $35,241 (for one child) or $37,263 (for two children).[152] For an income-splitting gay couple with children, however, the credit may not begin to phase out until the couple's income reaches $30,780 and may not finish phasing out until that income reaches $66,482 (under the one child rule) or $75,566 (under the two child rule).[153] Given that the median household income in the United States is about $45,000,[154] $75,566 seems a high cut-off point for an anti-poverty program.

These two computational advantages, however, represent only part of the problem. Married couples tend to pool their financial resources. For this reason, in computing earned income credit eligibility, the Code requires that spousal income be taken into account.[155] If Spouse *A* makes $300,000 and Spouse *B* $10,000, we do not typically think of Spouse *B* as poor or requiring governmental assistance. Therefore, for heterosexual married couples, earned income credit eligibility depends on the couple's combined AGI, regardless of whether they file jointly. Our hypothetical heterosexual married couple with a combined AGI of $310,000 will clearly not be eligible for the credit.

But what if the couple is gay? What if the couple is married as a matter of state law? The two spouses live together; they share expenses; they are committed to each other for the long term. Is Spouse *B*, with her $10,000 of AGI, poor and deserving of the earned income tax credit? According to current federal tax law, yes. If she otherwise meets the requirements of Section 32, she is entitled to a cash anti-poverty subsidy from the federal government through the earned income credit mechanism.[156] DOMA instructs us to ignore the fact

150. Rev. Proc. 2006-53, *supra* note 118, Sec. 3.01.

151. *Id.*

152. *Id.*

153. *Id.*

154. Census Bureau, *Three-Year-Average Median Household Income by State: 2002-2004*, http://www.census.gov/hhes/www/income/income04/statemhi.html (last visited Oct. 3, 2008) (on file with the Washington and Lee Law Review).

155. *See* I.R.C. § 32(d) (2002 & West Supp. 2008) (providing that "[i]n the case of an individual who is married . . . , this section shall apply only if a joint return is filed for the taxable year under section 6013").

156. *Id.* § 32.

that she is legally married to, and pools her financial resources with, Spouse *A*, who earns $300,000 a year. We are to treat her as single.

Ironically, if our gay couple lives in California and has registered as a domestic partnership, community property rules and *Seaborn* attribute half of Spouse *A*'s AGI to Spouse *B*, disqualifying her for the credit, at least on these facts.[157] Presumably, California gay couples in this situation will claim the benefit of the IRS's position in CCA 200608038, which asserts that no part of Spouse *A*'s personal services income should be attributed to Spouse *B* for any purpose.[158] Note, however, that even in California and even if we ignore CCA 200608038, only half of Spouse *A*'s AGI is attributed to Spouse *B*. Spouse *A* can therefore make considerably more than a comparable spouse in a heterosexual married couple before completely disqualifying Spouse *B* for the credit. And if CCA 200608038 correctly states the law or Congress overrules *Seaborn*, gay Spouse *B* would qualify for the earned income credit even in California.

Finally, the credit is not allowable if the otherwise qualified individual or couple has more than $2,900 of 2007 investment income for the year.[159] Again, there are problems with the way this limitation is structured. First, the cap is the same for single taxpayers as it is for married couples. This means that a couple treated as unmarried—a legally married gay couple, for example—can effectively receive up to twice as much investment income ($5,800 in 2007) without either spouse being disqualified. But worse and more likely, a gay couple will simply ensure that all investment income is received by the spouse not claiming the credit. Spouse *A* could be a trust fund baby, rolling in millions per year of unearned cash; Spouse *B* can still claim the credit—although not, perhaps, if they are California registered domestic partners.

As has already been discussed in Part II.D, one can even imagine structuring a gay couple's affairs so as to create creditable earned income where none otherwise exists. Spouse *A* is a lawyer; Spouse *B*, a stay-at-home mom or

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157. I.R.C. § 32(c)(2)(B)(i) provides that for purposes of defining "earned income," "the earned income of an individual shall be computed without regard to any community property laws." *Id.* This means that taxpayer herself must earn income in order to qualify for the earned income credit. But I.R.C. § 32(c)(2)(B)(i) apparently does not apply—and therefore community property rules and *Seaborn* apparently do apply—in computing taxpayer's "adjusted gross income," which is then used to phase-out the earned income credit as taxpayer's income rises. *Id.*

158. *See* IRS CCA, *supra* note 142 ("[A]n individual who is a registered domestic partner in California must report all of his or her income earned from the performance of his or her personal services.").

159. *See* Rev. Proc. 2006-53, *supra* note 118, Sec. 3.07(2) (setting the level of investment income that precludes recipients from taking advantage of the earned income tax credit).

dad. Spouse *A* hires Spouse *B* to perform services in their joint home. This payment does not normally result in any deduction to Spouse *A*,[160] but it can be structured to maximize Spouse *B*'s earned income credit, thereby reducing the couple's aggregate federal income tax liability. As has already been noted, the arrangement may also result in Social Security tax liability. This disadvantage, however, is offset by the fact that Spouse *B* will thereafter be eligible for Social Security benefits the present value of which are far greater than the Social Security tax payments themselves. Because heterosexual spousal income is taken into account in determining eligibility for the credit, this tax reduction technique is denied to heterosexual married couples. It remains open, however, to gays.

C. Avoiding Taxation of Social Security Benefits

Under Section 86, Social Security benefits are at least partially taxable to higher-income recipients.[161] If taxpayer has no other source of income, such benefits remain untaxed. As taxpayer's "modified adjusted gross income"[162] and one-half of Social Security benefits together increase past a "base amount" and then past an "adjusted base amount," first 50% and then 85% of such benefits are included in gross income.[163] Most of the specifics of this computation are irrelevant to this Article. What is important is that the base amounts and adjusted base amounts for heterosexual married couples ($32,000 and $44,000, respectively) are less than twice the corresponding numbers for single taxpayers ($25,000 and $34,000, respectively).[164] This means that Social Security beneficiaries treated as unmarried—legally married gay spouses, for example—are less likely to be subject to federal income tax on their benefits.

160. At some income levels for Spouse *A*, the arrangement can be structured to qualify for the Section 21 credit for expenses for household and dependent care services necessary for gainful employment. Because gay spouses are not treated as related, the related-party anti-abuse rules of I.R.C. § 21(e)(6) do not apply.

161. I.R.C. § 86 (2002 & West Supp. 2008).

162. Under I.R.C. § 86(b)(2), "modified adjusted gross income" equals adjusted gross income (not including Social Security or Tier 1 Railroad Retirement benefits) "without regard to this section and sections 135, 137, 199, 221, 222, 911, 931, and 933." *Id.*; *see id.* § 135 (excluding interest on savings bonds used to finance education); *id.* § 137 (excluding employer-paid adoption expenses); *id.* § 221 (deducting interest on qualified educational loans); *id.* § 222 (deducting qualified tuition and higher education expenses after 2001 and before 2006); *id.* § 911 (excluding foreign earned income); *id.* § 931 (excluding income from U.S. possessions); *id.* § 933 (excluding income from Puerto Rico).

163. *Id.* § 86(a).

164. *Id.* § 86(c).

But again, an even more serious problem is created by the lack of income attribution from one gay spouse to another. If a heterosexual married couple files jointly, spousal income is taken into account for purposes of determining whether Social Security benefits are taxable. If a heterosexual married couple files separately but lives together, both the base amount and the adjusted base amount drop to zero, as a result of which 85% of Social Security benefits become taxable immediately, without regard to "modified adjusted gross income."[165] By contrast, the incomes of gay spouses are never attributed to each other for any such purpose. As a result, marriage to a high-income same-sex partner will never cause Social Security benefits to become taxable.

In California, again, at least some of these tax advantages are tempered by community property rules and *Seaborn*.[166] And again, gay California taxpayers disadvantaged by *Seaborn* are likely to invoke the IRS's position in CCA 200608038 to avoid taxation of their Social Security benefits. The same is true of Social Security-eligible heterosexual couples. If they remain married, their Social Security benefits will be taxable under the rules applicable to heterosexual married couples generally, described above. If instead they divorce and reregister as California domestic partners, they should be able to invoke the CCA to avoid or minimize such taxation.

D. Claiming Other Tax Benefits Limited to Low- or Middle-Income Taxpayers

Many other exclusions, deductions, or credits are supposed to be limited to low or middle-income taxpayers. In applying such limitations, the Code—recognizing the failure of the assumption of selfishness characteristic of marriage—almost always requires that heterosexual married couples pool their income. Gay couples, of course, are not subject to any such requirement. As a result, a lower-earning gay spouse may remain entitled to some or all of these exclusions, deductions, or credits notwithstanding her marriage to a higher-earning spouse. Among the taxpayer-favorable provisions closed to lower-earning heterosexual spouses that remain open to lower-earning gay spouses are the Section 135 exclusion of income from U.S. savings bonds used to pay higher education tuition and fees,[167] the Section 22 credit for the elderly and

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165. *Id.*

166. *See supra* note 157 (describing how community property rules and *Seaborn* apply in calculating the AGI of registered domestic partners).

167. I.R.C. § 135 (2002 & West Supp. 2008).

permanently disabled,[168] the Section 25A Hope and Lifetime Learning credits,[169] and the Section 25B credit for up to 50% of qualified retirement savings contributions.[170]

California registered domestic partners, again, are deprived of some of the advantages of the Code's failure to attribute income from one gay spouse to another, since state law attributes half of each spouse's community income to the other and *Seaborn*, if applicable, respects that attribution.[171] Again, gay California taxpayers disadvantaged by *Seaborn* are likely to take advantage of the IRS's position in CCA 200608038 to avoid such attribution.

E. Claiming Both the Standard Deduction and Itemized Deductions

Section 63 allows taxpayers to claim either a "standard deduction" or their itemized deductions.[172] Subsection (c)(2) defines the standard deduction for a married couple filing jointly as twice the standard deduction for single taxpayers.[173] The result generally is to tax married taxpayers on a pooled income basis without additional penalty.

Subsection (c)(7), however, allows a married taxpayer who files separately to claim the standard deduction only if her spouse does likewise.[174] The purpose of this special related-party rule is to prevent couples from loading below-the-line deductions into the separate return of one of the two spouses, so that the other can then claim the standard deduction. If this technique were allowed to succeed, the couple would in effect get the benefit of a single-taxpayer standard deduction in addition to, rather than instead of, the couple's itemized deductions. Subsection (c)(7) precludes use of this technique by heterosexual married couples. It does not, however, apply to couples treated as unmarried, including legally-married gay couples. Gay couples can therefore both have their cake and eat it too—both itemize and claim the standard deduction.

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168. *Id.* § 22.

169. *Id.* § 25A.

170. *Id.* § 25B.

171. *See* Poe v. Seaborn, 282 U.S. 101, 118 (1930) (allowing couples in community property states to income-split).

172. I.R.C. § 68(c), (d) (2002 & West Supp. 2008).

173. *Id.* § 68(c)(2).

174. *Id.* § 68(c)(7).

F. Claiming the Adoption Credit When Adopting a Spouse's Child

I close this Part III with a particularly ironic tax advantage of gay marriage. Section 23 authorizes a credit of up to $11,390 (in 2007) for adoption expenses,[175] but excludes expenses incurred in adopting the child of one's spouse.[176] This is because the credit is intended to encourage the adoption of not-previously-related children, in part to create a tax-subsidized alternative to abortion. If a heterosexual married person adopts her spouse's child, therefore, such expenses are not eligible for the credit. Since gay spouses are not "spouses" for Code purposes, however, the Section 23 credit remains available when one gay spouse adopts the child of the other. Such adoptions appear to be allowed in about half of all U.S. states.[177] The bottom line is that, because of DOMA, the Code subsidizes adoptions by gay parents in contexts in which it explicitly declines subsidies to identically-situated heterosexuals.

Like Part II, Part III explores only a small subset of the Code's related-party rules. Many other related-party anti-abuse rules triggered only by marriage are scattered throughout the Code. In each case, such special rules are deemed necessary because of the failure of the assumption of selfishness characteristic of marriage. None of these special rules apply to gay couples. As a result, many other tax-minimization techniques not described here remain open to gays.

IV. Lessons and Solutions

I turn finally to general lessons that may be drawn from the diverse technical threads of the first two parts. Part IV.A compares the explanatory power of my thesis with that of existing modes of related-party-provision analysis—"benefits and burdens of ownership," "taxable unit," and "marriage penalty." It concludes, unsurprisingly, that my thesis explains a greater range of related-party provisions than any other, and does so more convincingly. Part IV.B returns to the unintended tax advantages of gay marriage and, in particular, to possible Congressional responses. It concludes that the only unambiguously effective way to prevent gay couples from undertaking the broad range of tax-driven transactions now prohibited to heterosexual married

175. Rev. Proc. 2006-53, *supra* note 118, Sec. 3.01.

176. I.R.C. § 23(d)(1)(C).

177. *See, e.g.*, Nicole M. Shkedi, Comment, *When Harry Met Lawrence: Allowing Gays and Lesbians to Adopt*, 35 SETON HALL L. REV. 873, 883 n.57 (2005) (noting that twenty-six states have failed to extend the stepparent exception to same-sex partners).

couples is to create an attractive formal status for gay couples and to list that status as one of the proxy relationships that automatically invokes the pertinent anti-abuse rules.

A. Theorizing Related-Party Issues

The first two parts of this Article outline techniques through which gay couples can effectively pay lower taxes than heterosexual married couples—or, indeed, than single taxpayers, gay or straight. But so what? My ultimate thesis, please recall, is theoretical, not practical:

1. the Code's general rules are written on the assumption that taxpayers are self-interested, unaffiliated individuals;
2. where this assumption of selfishness proves or is likely to prove incorrect, the Code makes adjustments to its otherwise applicable rules;
3. although some such adjustments facilitate transfers between interpersonally committed individuals, most are designed to prevent tax abuse;
4. some related-party anti-abuse rules apply on a facts-and-circumstances basis, regardless of the formal relationship between the parties;
5. most, however, apply only in the context of specified formal relationships, regardless of whether the transaction is undertaken on arm's-length terms; and
6. when the assumption of selfishness fails and the relevant related-party anti-abuse rules explicitly do not apply we are likely to perceive the results as tax-abusive.

This Article has largely ignored both the taxpayer-favorable related-party rules acknowledged in section (3) and the anti-abuse rules imposed on a facts-and-circumstances basis acknowledged in section (4). Full elaboration of the foregoing theoretical thesis will be a long-term project.

Nevertheless, in my introduction, I promised that in each of the contexts explored in Parts I and II, readers committed to fair taxation would be troubled by the consequences of not including gay marriage as a listed relationship automatically invoking the rule in question, regardless of their views of the merits of gay marriage itself. I believe I have kept that promise. Because gay marriage involves a probable failure of the assumption of selfishness, tax-driven transactions that would be unattractive to self-interested, unaffiliated individuals remain attractive and open to gay spouses. As a result, well-advised gay couples can often arrange their affairs so as to face systematically lower federal income tax liabilities than their identically-situated heterosexual counterparts. This seems wrong. My analytic approach explains why. Its competitors, for the most part, do not.

1. "Benefits and Burdens of Ownership" Approach

The "benefits and burdens of ownership" approach was originally developed to justify enactment of a single related-party anti-abuse provision—Section 267.[178] It is most plausible in explaining the disallowance of losses on sales to related parties under Section 267(a)(1); somewhat less plausible is explaining the matching rules of Section 267(a)(2), discussed in Part II.C above. It can be extended, with varying degrees of success, to deal with at least some of other related-party anti-abuse rules discussed in Part II, but, as I have already noted, only with caveats. It has not traditionally been used to analyze rate issues or the taxation of marriage and offers little insight in that context. In particular, it offers no guidance as to whether joint rates should be set at either endpoint or anywhere in between. Finally, by itself, it tells us little about whether gay marriage should automatically trigger the related-party anti-abuse rules currently triggered by heterosexual marriage.

2. "Taxable Unit" Approach

The "taxable unit" approach is most persuasive in analyzing rate issues in the taxation of marriage. Even in that context, however, it is indeterminate. If we believe that the proper "taxable unit" is the married couple, taxable unit analysis supports the principle of couples neutrality. If we believe it is the individual, the same analysis rejects couples neutrality and supports instead the disparate treatment of traditional and two-earner—or common law and community property—couples that led to joint returns in the first place. The approach itself, however, offers no compelling reason to go one way or the other. Nor, if we opt for couples neutrality, does taxable unit analysis give us any strong reason to set joint rates at either endpoint or any point between. Finally, if we conclude that heterosexual married couples are appropriate "taxable units" but gay couples are not, taxable unit analysis gives us no reason to object to any of the tax disparities identified in Parts I and II above.

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178. *See supra* note 14 and accompanying text (explaining that I.R.C. § 267 was introduced to combat abusive transactions among related parties).

3. *"Marriage Penalty" Approach*

The "marriage penalty" approach has sometimes proven useful in analyzing the incentive effects of rate structures. Professor McCaffery's work on the incentives women face when deciding whether to work outside the home comes particularly to mind.[179] Outside this context, however, its power to frame exceeds its power to illuminate. Marriage penalty analysis invites us to be outraged if *any* heterosexual couple pays more federal income tax married than unmarried. This conclusion is inherent in the way the issue is stated. The question asked is not whether married and single individuals with similar incomes pay the same tax *on average*. If *any* married couple is disadvantaged, a marriage penalty exists. And the name itself is pejorative. Much as we might support an "estate tax" but feel compelled to repeal a "death tax," having framed the joint-return rate-setting problem in marriage penalty terms, we feel compelled to eliminate anything so named. The only obviously defensible solution, from a marriage penalty perspective, is to set all rates at the two-earner endpoint—indeed, to set all numerical cut-offs for joint-return filers at exactly twice the corresponding level for single taxpayers.

Even in analyzing the problem of marriage penalties, however, marriage penalty analysis misses much that is relevant. What is conventionally referred to as a marriage penalty is the by-product of a related-party anti-abuse rule—to wit, the joint return system authorized by Congress to deal with the problem of income-splitting, itself a tax-minimization technique. Although Congress's 1948 authorization of the joint return system was triggered by income-splitting effected by community property rules,[180] the problem actually arises whenever taxpayers use *any* income-splitting technique to reduce the effects of progressive taxation. Income-splitting, in turn, becomes likely if and only if there is a major failure of the assumption of selfishness, as in marriage; self-interested, economically independent individuals will not income-split merely to save taxes. Community property rules merely recognize, as a matter of nontax law, the income-splitting that would likely occur in marriage anyhow; *Seaborn* then respects the resulting state property arrangements for tax purposes. An analysis that focuses solely on marriage penalties thus focuses on

179. *See generally* Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 UCLA L. REV. 983 (1993).

180. *See* S. REP. NO. 80-1013 (1948), *as reprinted in* 1948 U.S.C.C.A.N. 1163, 1184–87 (stating that a primary reason for authorizing joint filing returns in the Revenue Act of 1948 was to deal with differences in income splitting between common law and community property jurisdictions).

only one of many side effects of Congress's solution to the income-splitting problem, not on the underlying problem itself.

4. *"Assumption of Selfishness" Approach*

My thesis, by contrast, fits and justifies related-party anti-abuse rules across the Code. It handles the discrete anti-abuse problems described in Part II with ease. It provides an analytically complete account of the problem of taxing interpersonally committed couples. Ultimately, it may allow an integrated analysis of both facts-and-circumstances and relationship-based anti-abuse rules, on the one hand, and taxpayer-favorable related-party rules, on the other.

It can even lead to a determinate answer to the joint-return rate-setting problem. If one characterizes that problem as one of constraining tax minimization, as an "assumption of selfishness" approach does, the task becomes one of ensuring horizontal equity between classes of taxpayers. If so, we can begin with the premise that joint-filing rates should be set so as to ensure that married and single individuals with similar incomes pay the same *average* taxes—in other words, to ensure that the 50.3% of "single"-taxpayer households do not end up subsidizing the 49.7% of married-couple households, or vice versa. Given time and access to the IRS database, such a rate structure is easy enough to compute; we might call it the "joint-filing midpoint." My point is not that rates should be set at this midpoint. My point is rather that this point is a more defensible starting point—that any departure from the midpoint should be made consciously.

Even the joint-filing midpoint may not itself be completely fair. The notion that taxes should be imposed in accordance with ability to pay retains a strong normative appeal, at least within the electorate.[181] If we care about ability to pay, we need to ask whether married and single individuals with similar incomes have, on average, the same ability to pay taxes. The answer is probably "no"; at similar income levels, single taxpayers probably make a larger objective sacrifice to pay comparable amounts. This is because a married couple needs only one home, one of each of the major appliances, perhaps one computer, perhaps one car. At any income level, spouses who pool their resources typically have more income available for discretionary use than they

181. See generally Theodore P. Seto & Sande L. Buhai, *Tax and Disability: Ability to Pay and the Taxation of Difference*, 154 U. PA. L. REV. 1053 (2006) for an extended discussion of the principle that taxes should be imposed based on ability to pay and its abandonment by some tax theorists.

would living in separate households. Even if we impose the same average taxes on married and single taxpayers at comparable income levels, we are probably asking for a higher level of objective sacrifice from single taxpayers than we are from married taxpayers. From this perspective, gay couples look a lot more like heterosexual married couples than like singles. A gay couple similarly needs only one home, one refrigerator, one washing machine, one dryer, and so forth. When gay spouses pool their resources and thereby free up more of their income for discretionary use, ability-to-pay tax principles suggest that they should be taxed as heavily as heterosexuals who do the same. Currently, because of DOMA, they are not.

B. Eliminating the Unintended Tax Advantages of Gay Marriage

I began this Article by asking whether gay marriage should automatically trigger related-party anti-abuse rules currently triggered by heterosexual marriage. Before concluding definitively that it should, I need to consider alternatives. Some of the problems I have identified can be solved by technical fixes, although not without costs, and sometimes only partially. For most of the problems I have discussed, however, there do not appear to be any effective technical fixes. Unless we are willing to require taxpayers to disclose each year, under penalties of perjury, the persons with whom they live and have regular sexual relations and to treat such persons as "related" for purposes of the relevant anti-abuse provisions, we must either treat gay marriage as analogous to heterosexual marriage for purposes of those rules or resign ourselves to allowing gay couples to pay systematically lower federal income taxes than their heterosexual married counterparts.

The problems of income-splitting, joint-return filing, and "marriage penalties" discussed in Part III.A, however, do require further discussion before I close.

1. Repeal or Limitation of Poe v. Seaborn

One possible solution to some of the income-splitting problems identified in Part III.A would be for Congress to repeal *Poe v. Seaborn* in whole or in part, or for the courts to limit its application to heterosexual marriage. Most saliently, such a step would deny California same-sex registered domestic partners the automatic rate advantages created by de jure income-splitting under California law.

Congress has already partially repealed *Seaborn* in two limited contexts. Section 879(a) applies to nonresident alien individuals.[182] In the absence of special rules, half of any community income earned in the United States may escape U.S. taxation merely by reason of the fact that it is attributed to a nonresident alien spouse, who may have no contact whatever with this country.[183] In addition, since U.S. citizens are taxable on their worldwide income, a U.S. citizen married to a resident of a community property country may find herself subject to U.S. tax on half her spouse's earnings solely by reason of foreign community property rules.[184]

To avoid these problems, Section 879(a) divides all income into four categories and provides as follows:

> 1. Earned income . . . , other than trade or business income and a partner's distributive share of partnership income, shall be treated as the income of the spouse who rendered the personal services,
>
> 2. Trade or business income, and a partner's distributive share of partnership income, shall be [taxable to "the spouse carrying on such trade or business or, if such trade or business is jointly operated, treated as the gross income and deductions of each spouse on the basis of their respective distributive share of the gross income and deductions"],[185]
>
> 3. Community income not described in paragraph (1) or (2) which is derived from the separate property (as determined under the applicable community property law) of one spouse shall be treated as the income of such spouse, and

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182. I.R.C. § 879(a) (2002).

183. *Id.*

184. *Id.*

185. The bracketed language is excerpted from I.R.C. § 1402(a)(5) (2002 & West Supp. 2008), invoked by cross-reference in I.R.C. § 879(a)(2). *Id.* § 879(a)(2). The pertinent regulations issued have not yet incorporated modern attitudes towards gender equality. Treas. Reg. § 1.1402(a)–(8)(a) (2008) states in part:

> If any of the income derived by an individual from a trade or business . . . is community income . . . , all of the gross income, and the deductions attributable to such income, shall be treated as the gross income and deductions of the husband unless the wife exercises substantially all of the management and control of such trade or business, in which case all of such gross income and deductions shall be treated as the gross income and deductions of the wife.

Id. This rule is taken from the relevant House and Senate Reports. *See* H.R. REP. NO. 94-658, at 205 (1976), *as reprinted in* 1976 U.S.C.C.A.N. 2847, 3100; S. REP. NO. 94-938, at 214 (1976), *as reprinted in* 1976 U.S.C.C.A.N. 3439, 3644. How it would be applied to gay couples is unclear.

4. All other such community income shall be treated as provided in the applicable community property law.

In other words, in the case of nonresident alien individuals, Section 879(a) disregards community property rules with respect to earned income and trade or business income but continues to respect those rules with respect to income from property. In effect, the repealer implements the basic assignment of income principles of *Lucas v. Earl* and *Helvering v. Horst*[186]—income from labor is taxed to the person who earns it; income from property to the person who owns the property.

Section 66 similarly governs the taxation of community income when a U.S. married couple lives apart and does not in fact pool its earned income. Subsection (a) states that if the couple lives apart at all times during the calendar year and files separate returns, and if no portion of the community earned income is transferred between the separated spouses during the year, such income will be taxed in accordance with the rules of Section 879(a).[187] Subsection (b) allows the IRS to deny a taxpayer the benefits of community property law if she behaves as if she were solely entitled to community income and fails to notify her spouse of such income on a timely basis.[188] Subsection (c), finally, allows the IRS by regulation to relieve a taxpayer of liability for tax on community income if she files separately, does not report that income, has no reason to know of that income, and taxing her on that income would be inequitable.[189]

Neither section constitutes a wholesale repealer. A heterosexual married spouse in California who files separately but does not meet the requirements of Section 66 must still include her half of any community income in that separate return.[190] Income from property is still taxed to the spouse deemed, under community property law, to own that property.[191]

CCA 200608038 appears to attempt to reach the same bottom line—in effect, to apply Section 879 to California registered domestic partners.

186. *See* Helvering v. Horst, 311 U.S. 112, 120 (1940) (finding that interest payments on negotiable interest coupons were taxable to the donor of the coupons, despite the fact that he had assigned them and their payments to his son—"the fruit is not attributed to a different tree from that on which it grew").

187. I.R.C. § 66(a) (2002).

188. *Id.* § 66(b).

189. *Id.* § 66(c).

190. *See* United States v. Malcolm, 282 U.S. 792, 794 (1931) (declaring that a spouse in California has sufficient interest in community income that she should report separately and pay taxes on half of that income).

191. *See* I.R.C. § 879(a)(3) (2002 & West Supp. 2008) (declaring that community income from property is only taxable to the owner of that property).

Unfortunately, *Seaborn* cannot easily be so construed. I am left with the impression that the Chief Counsel Advisory's result is more plausible than its reasoning. Even that result, however, is questionable.

The basic problem is that *Seaborn* stands, fundamentally, for the proposition that federal tax law should respect state property law. The practical reason, not well-articulated in *Seaborn* itself, is simple: If and to the extent that federal tax law does not respect state property law, taxpayers and the IRS will need to keep separate track of who owns what for federal tax purposes. One of the great strengths of the federal tax system is its internal consistency. Every taxpayer can be thought of as having both a balance sheet and an income statement—in accounting terms, both stocks and flows. Whenever property moves from one balance sheet to another, consistency requires that the relevant income statements reflect that movement.

In a world in which both men and women earn money and own property, joint return filing substantially simplifies the relevant accounting. For most income tax purposes, the couple has only one balance sheet and one income statement; interspousal transfers are, for the most part, nonevents. Notwithstanding the fact that *Lucas v. Earl* and other assignment of income cases sometimes deviate from state law, joint return filing eliminates, for the most part, any need to keep track of such deviations.

In the absence of joint return filing, accounting for a gay couple's stocks and flows is already a largely ignored nightmare—beyond the ability of ordinary taxpayers, however honest and well-intentioned, and beyond the routine audit capabilities of the IRS. Delinking the federal tax system from state property law would make such accounting hopeless. Each spouse would need to keep track of her own stocks and flows—most importantly, of the daily flows between the two spouses. She would need to do so not only as a matter of state property law, but also, *under different rules*, as a matter of a federal tax law. In effect, every gay couple would need to keep four sets of books, and ordinary IRS agents would be expected to understand and audit them.

The few contexts in which Congress has chosen to overrule *Seaborn* have been sufficiently limited to avoid this problem. Section 879 assumes only minimal compliance with U.S. tax rules by nonresident aliens.[192] Section 66 applies only to couples who are not pooling their finances in any event.[193] Overruling *Seaborn* with respect to gay couples who routinely pool their

192. *See id.* § 879 (applying community property rules to income from property in cases where one or both of the spouses in a married couple is a nonresident alien).

193. *Id.* § 66.

finances and are expected to comply voluntarily with U.S. tax law—or worse, overruling *Seaborn* generally—would completely overload the system.

In any event, as I have already noted, the income-splitting tax advantages of gay marriage derive not from *Seaborn* but from the willingness of gay spouses to pool their financial resources. Even under a universally-applicable Section 879, gay spouses could structure their affairs so as to income-split. Tax lawyers would collect more fees, but the federal government would not necessarily collect more taxes. So long as income-splitting gay spouses remain exempt from the joint-return rules, they may still pay federal income taxes at lower effective rates than heterosexual married couples. And most of the rest of the problems identified in the first two parts of this Article would not be addressed at all by such a rule change.

2. *Elimination of "Marriage Penalties"*

If all "marriage penalties" were eliminated, at least some of the unintended tax advantages of gay marriage discussed in Parts I and II above would be eliminated as well. This could be accomplished by setting all income and expense cut-off figures for married couples at twice the corresponding figure for single taxpayers—that is, by setting all such figures at the two-earner endpoint.

Under such a partial solution, unfortunately, single taxpayers as a class would be called upon to fund the operations of the federal government at a rate disproportionate to their incomes. Whether this would be fair or desirable for reasons apart from fairness, it would almost certainly provoke a political reaction in the long run. As I have already noted, singles probably face higher costs of daily living than married individuals at comparable income levels, not lower.

In addition, setting cut-off figures for married couples at twice the corresponding figure for single taxpayers, across the board, would significantly undermine the purposes of many affected provisions. The earned income credit of Section 32, for example, is intended to ameliorate the plight of the working poor.[194] Single taxpayers with children are among the most important groups thus targeted. To cut their earned income credit rates to half those of comparably situated heterosexual married couples would devastate that target group. Such a change would also have geographic implications.[195]

194. *See* Zelenak, *supra* note 27, at 304–05 (expounding the history of the earned income credit and its role in alleviating poverty).

195. *See* U.S. Census Bureau, *New Analysis Offers First-Ever State-by-State Look at Links*

Most importantly, however, adjusting cut-off figures for married couples would do nothing whatever to solve problems caused by the Code's current failure to attribute the income of one gay spouse to the other. It would do nothing, for example, to prevent gay Spouse *B*, who earns $10,000 per year, from collecting the earned income credit while married to gay Spouse *A*, who earns $300,000. It would also do nothing to solve any of the problems I have discussed other than the marriage penalty problem.

3. *Treatment of Gay Marriage as "Marriage" for Code Purposes*

The only way to solve all, or even a majority, of the tax-avoidance problems identified in this Article is to treat gay marriage as analogous to "marriage" for Code purposes. Gay spouses, who behave unselfishly *inter se* much as heterosexual spouses do, would then be subject to the same related-party rules imposed on heterosexual married couples to prevent tax-abusive transactions made possible by this failure of the assumption of selfishness.

Congress could, of course, impose only the bad tax consequences of marriage on gay couples, and none of the good. There are at least two problems with such an approach. First, it would heighten the likelihood of success of an equal protection challenge. Second, in the face of such an approach, gay couples would likely not register their marriages with civil authorities. As they do now in most states, they would take their vows in accordance with their religious convictions but remain off the official rolls. At the same time, they would continue using the techniques outlined in this Article, and others like them, to minimize taxes.

As I noted at the outset, to solve most of the problems identified in this Article, it is not sufficient simply to treat gay marriage as analogous to "marriage." There must first be a formal status into which gays can voluntarily enter, which status can then be used to invoke related-party rules. At this writing, eleven U.S. jurisdictions authorize the celebration of some form of legally formalized same-sex relationship, and three others honor such relationships if entered into elsewhere. A majority of states, by contrast, have ratified state constitutional provisions that prohibit their courts and sometimes their legislatures from traveling down this road, to one extent or another.[196] If

Between Marriage, Fertility and Other Socioeconomic Characteristics, (Oct. 13, 2005) http://www.census.gov/Press-Release/www/releases/archives/fertility/005807.html (last visited Oct. 3, 2008) (showing that Southern states have a higher percentage of unwed mothers with infants) (on file with the Washington and Lee Law Review).

196. *See* ALA. CONST. amend. 774 (recognizing no same-sex marriage or similar unions); ALASKA CONST. art. 1, § 25 (recognizing no same-sex marriage, but remaining silent as to other

there is to be a formal status available nationwide, therefore, it must be federal. Marriage, however, has traditionally been within the exclusive domain of the states.

The fact that we are trying to solve a tax problem, however, suggests one possible federal solution. Congress could create a new status for federal tax purposes, which for ease of reference might be called a "tax domestic partnership." Gay couples could register as tax domestic partners with the Internal Revenue Service. A tax domestic partnership would then be defined to include (1) any couple so registered, and (2) any gay couple married or registered as a domestic partnership or civil union under state law or the law of

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types of same-sex unions); ARK. CONST. amend. 83 (declining to recognize same-sex unions entered into elsewhere, and placing all power to determine who may marry and the "legal rights, obligations, privileges, and immunities of marriage" in the state legislature); ARIZ. Proposition 102, http://www.azsos.gov/election/2008/Info/PubPamphlet/english/contents.htm (last visited Nov. 13, 2008) (recognizing no same-sex marriage) (on file with the Washington and Lee Law Review); CAL. Proposition 8, *supra* note 31 (same); COLO. CONST. art. 2, § 31 (recognizing only marriage between one man and one woman as valid); FLA. amend. 2, http://election.dos.state.fl.us/initiatives/initdetail.asp?account=41550&seqnum=1 (last visited Nov. 13, 2008) (recognizing no same-sex marriage or similar unions) (on file with the Washington and Lee Law Review); GA. CONST. art. I, § IV, ¶ 1 (recognizing neither same-sex unions entered into elsewhere, nor judicial jurisdiction over same-sex unions); HAW. CONST. art. I, § 23 (declaring that the legislature has power to reserve marriage to opposite-sex couples); IDAHO CONST. art. III, § 28 (recognizing no same-sex partnerships); KAN. CONST. art. 15, § 16 (recognizing only marriage between man and woman as valid); KY. CONST. § 233(A) (recognizing neither same-sex marriage, nor any "substantially similar" legal status); LA. CONST. art. XII, § 15 (same); MICH. CONST. art. I, § 25 (recognizing no same-sex marriage or "similar union"); MISS. CONST. art. 14, § 263-A (recognizing no same-sex marriage, but remaining silent as to other types of same-sex unions); MO. CONST. art. I, § 33 (same); MONT. CONST. art. XIII, § 7 (providing for no recognition of same-sex marriage); NEB. CONST. art. I, § 29 (recognizing no same-sex marriage or "other similar same-sex partnerships"); NEV. CONST. art. 1, § 21 (recognizing only marriage between man and woman); N.D. CONST. art. XI, § 28 (recognizing no same-sex marriage and giving no other same-sex unions "substantially equivalent legal effect"); OHIO CONST. art. 15, § 11 (recognizing no same-sex marriage or other union "intend[ed] to approximate the design, qualities, significance or effect of marriage"); OKLA. CONST. art. 2, § 35 (recognizing neither same-sex marriage, nor allowing for the benefits of marriage to be "conferred upon unmarried couples or groups"); OR. CONST. art. 15, § 5(a) (recognizing only marriage between one man and one woman as valid); 23 PA. CONS. STAT. §§ 1102, 1704 (2008) (recognizing neither same-sex marriages, nor civil unions); S.C. CONST. art. XVII, § 15 (extending no recognition or validity to same-sex unions); S.D. CONST. art. XXI, § 9 (providing no recognition or validity for any form of same-sex relationship); TENN. CONST. art. XI, § 18 (recognizing only marriage between a man and a woman); TEX. CONST. art. 1, § 32 (declaring that marriage consists of union between a man and a woman, and allowing no recognition of "any legal status identical or similar to marriage"); UTAH CONST. art. I, § 29 (providing no recognition of any type of same-sex partnership); VA. CONST. art. I, § 15-A (recognizing no same-sex marriage or any legal status designed to approximate marriage); WIS. CONST. art. XIII, § 13 (recognizing neither same-sex marriage nor anything "substantially similar").

any foreign jurisdiction. Tax domestic partnership, so defined, would then have the same U.S. tax consequences as marriage—the good, the bad, and the ugly.

My suspicion is that many gay couples would so register, notwithstanding the fact that tax domestic partnership status might not entitle them to any rights under state law. To the extent they did so, all of the problems I have identified in this Article would be solved—not completely, but to the same extent they are solved under current law with respect to heterosexual couples.

V. Conclusion

The Internal Revenue Code's general rules are written on the assumption that taxpayers are self-interested, unaffiliated individuals. Where this assumption of selfishness proves or is likely to prove incorrect, the Code makes adjustments to those general rules. Although some of these adjustments facilitate transfers between interpersonally committed individuals, most are designed to prevent tax abuse. Some related-party anti-abuse rules apply on a facts-and-circumstances basis, regardless of the formal relationship between the parties. Most, however, apply only in the context of specified formal relationships, regardless of whether the transaction is undertaken on arm's-length terms. When the assumption of selfishness fails and the relevant related-party anti-abuse rules explicitly do not apply, we are likely to perceive the results as tax-abusive.

The Code's current failure to list gay marriage as a proxy relationship invoking related-party anti-abuse rules is therefore problematic. Gay couples are systematically advantaged by this failure. The problem is not just *Seaborn* or a failure to ensure that cut-offs for heterosexual married couples are always twice the cut-offs for single taxpayers. The problem is rather inherent in the Code's refusal to give tax effect to a specific type of failure of the assumption of selfishness—long-term interpersonal commitment between same-sex partners.

Rule systems work best when they take common human motivations into account. The U.S. tax system was designed in part by classically trained economists, whose standard model assumes rational atomistic actors. Over the decades, Congress has, by trial and error, accommodated that system to the fact that, contrary to the standard economic model, many taxpayers have deep interpersonal commitments. To date, we have lacked a tax theoretic framework for thinking about such commitments systematically. This Article is intended to begin to remedy that gap.