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## London Calling: Does the U.K.'s Experience with Individual Taxation Clash with the U.S.'s Expectations?

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**LONDON CALLING: DOES THE U.K.'S EXPERIENCE WITH  
INDIVIDUAL TAXATION CLASH WITH THE U.S.'S  
EXPECTATIONS?**

STEPHANIE HUNTER McMAHON\*

ABSTRACT

The United States is one of the last countries to tax married couples jointly; most other countries have adopted individual taxation. In 1990, the United Kingdom completed transitioning its tax system from one that treated husbands and wives as a marital unit to one that mandates an individual-based system, and so it has two decades of experience with the new regime. This article provides American policymakers valuable information regarding the consequences of adopting individual taxation by examining the United Kingdom's experience. First, it establishes a matrix of factors that identifies and assesses differences between the two nations that affect the predictive value of the United Kingdom's experience for the United States. The article then reviews the origins and development of the United Kingdom's original mandatory joint return and the forces that drove the change to individual taxation. Finally, it appraises the consequences of this revision of British law, including the improved economic position of many wives and the increased incidence of tax avoidance. Comparing the change in the United Kingdom with what would likely occur in the United States, this article uses comparative taxation to provide a guide for the United States, urging consideration of the costs as well as the benefits of changing tax units.

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## INTRODUCTION

Few would dispute that reinventing the wheel is generally a waste of time and resources, but Americans often do just that when considering changes to fiscal (and other) policies. While we as a nation sometimes analyze what has already been tried in the United States (U.S.), we rarely examine what has been undertaken abroad. This is unfortunate because some reforms currently being proposed in the U.S. are similar to those that have already been adopted by other countries. For example, the U.S. is one of the last countries to tax married couples as marital units.<sup>1</sup> In recent decades there has been a worldwide movement, which many American academics join, in favor of taxing spouses as individuals as a means of promoting gender equality.<sup>2</sup> Most

1. See CONG. BUDGET OFFICE, FOR BETTER OR FOR WORSE: MARRIAGE AND THE FEDERAL INCOME TAX 60 (1997).

2. See ORG. FOR ECON. CO-OPERATION & DEV., FUNDAMENTAL REFORM OF PERSONAL INCOME TAX 54–56, 114–26 (OECD Tax Policy Studies No. 13, 2006) (discussing the effect of an individual-based tax system on OECD member countries); EC Comm’n on Income Taxation & Equal Treatment for Men & Women, *Memorandum of 14 December 1984 Presented to the EC Council*, (COM (84) 695 final), reprinted in 39 BULL. INT’L FISCAL DOCUMENTATION 262, 265 (1985) [hereinafter EC Comm’n on Income Taxation] (noting that taxing individuals rather than couples has the most gender-neutral effect); Cathal O’Donoghue & Holly Sutherland, *Accounting for the Family in European Economic Income Tax Systems*, 23 CAMBRIDGE J. ECON. 565, 567–69 (1999) (discussing the traditional family model of taxation and its assumption that one spouse is financially dependent upon the other). Among the dozens of articles by American scholars on this topic, see generally ALICE KESSLER-HARRIS, IN PURSUIT OF EQUITY: WOMEN, MEN, AND THE QUEST FOR ECONOMIC CITIZENSHIP IN 20TH-CENTURY AMERICA 170–202 (2001) (discussing the history of the American system’s rejection of separate tax returns and highlighting its gender inequities); EDWARD J. MCCAFFERY, TAXING WOMEN (1997) (reviewing existing proposals and recommending legislative changes to achieve gender neutrality); Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389 (1975) (explaining how the income tax should change to adapt to changing social norms and ideals); Grace Blumberg, *Sexism in the Code: A Comparative Study of Income Taxation of Working Wives and Mothers*, 21 BUFF. L. REV. 49 (1972) (comparing American treatment of dual-earner couples with that of other nations); Amy C. Christian, *The Joint Return Rate Structure: Identifying and Addressing the Gendered Nature of the Tax Law*, 13 J.L. & POL. 241 (1997) (exploring how income splitting and aggregation harm women); Pamela B. Gann, *Abandoning Marital Status as a Factor in Allocating Income Tax Burdens*, 59 TEX. L. REV. 1 (1980) (arguing that a separate return system is the best solution for eliminating disparities in tax treatment based on gender and marital status); Wendy C. Gerzog, *The Marriage Penalty: The Working Couple’s Dilemma*, 47 FORDHAM L. REV. 27 (1978) (noting separate returns would further feminist goals and solve taxation disparities under the joint return system); Carolyn C. Jones, *Split Income and Separate Spheres: Tax Law and Gender Roles in the 1940s*, 6 LAW & HIST. REV. 259 (1988) (examining how income splitting ideas from the 1940s underlie current tax policy); Marjorie E. Kornhauser, *Love, Money, and the IRS: Family, Income-Sharing, and the Joint Income Tax Return*, 45 HASTINGS L.J. 63 (1993) (noting that women’s choice whether or not to work is affected by the current tax structure); James Edward Maule, *Tax and Marriage: Unhitching the Horse and the Carriage*, 67

of the American scholars who agree with this conclusion do so without examining the many real world examples of this change in policy that can be found outside America's borders.<sup>3</sup>

Advocates of individual taxation expect it to help wives gain greater equality within marriage because it eliminates the marriage penalty that results from applying progressive tax rates to joint returns.<sup>4</sup> When two individuals marry and their two incomes are combined for calculating the taxes due, more income is pushed into higher tax brackets, producing a larger collective tax burden than would be due if the spouses had not married.<sup>5</sup> As discussed more fully later in this article, this penalty is thought to burden wives more heavily than their husbands because wives' income often is considered secondary to the income earned by their mates.<sup>6</sup> Eliminating this penalty is expected to

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TAX NOTES 539 (1995) (arguing that to eliminate the "marriage penalty" altogether, a separate return system must be used); Michael J. McIntyre & Oliver Oldman, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 HARV. L. REV. 1573 (1977) (arguing for taxing individuals based on the benefit they receive from the family income); Shari Motro, *A New "I Do": Towards a Marriage-Neutral Income Tax*, 91 IOWA L. REV. 1509 (2006) (proposing that only couples committed to actual income splitting be allowed to do so for tax purposes); Lawrence Zelenak, *Marriage and the Income Tax*, 67 S. CAL. L. REV. 339 (1994) (examining the behavioral impact on women of the current joint return structure); Lora Cicconi, Comment, *Competing Goals Amidst the "Opt-Out" Revolution: An Examination of Gender-Based Tax Reform in Light of New Data on Female Labor Supply*, 42 GONZ. L. REV. 257 (2006-2007) (discussing the U.S. tax structure as an influence on educated women's decision not to work); Wendy Richards, Comment, *An Analysis of Recent Tax Reforms from a Marital-Bias Perspective: It is Time to Oust Marriage from the Tax Code*, 2008 WIS. L. REV. 611 (2008) (arguing that marriage bias in the tax code negatively affects both spouses and same-sex couples).

3. But see Norma Briggs, *Individual Income Taxation and Social Benefits in Sweden, the United Kingdom, and the U.S.A.: A Study of their Interrelationships on Lower-Income Couples and Single Heads of Household*, 39 BULL. INT'L FISCAL DOCUMENTATION 243 (1985) (reviewing how the U.K., U.S., and Swedish tax systems treat women); Oliver Oldman & Ralph Temple, *Comparative Analysis of the Taxation of Married Persons*, 12 STAN. L. REV. 585 (1960) (examining how various nations tax married couples); Joseph A. Pechman & Gary V. Engelhardt, *The Income Tax Treatment of the Family: An International Perspective*, 43 NAT'L TAX J. 1 (1990) (examining international efforts to reform taxes to account for family responsibilities); Tonya Major Gauff, Comment, *Eliminating the Secondary Earner Bias: Lessons from Malaysia, the United Kingdom, and Ireland*, 4 NW. J. L. & SOC. POL'Y 424 (2009) (examining the effects of tax reform on dual-earner couples in various countries); Janet G. Stotsky, *Gender Bias in Tax System* (Int'l Monetary Fund, Fiscal Affairs Dep't, Working Paper No. 96/99, 1996) (providing examples of countries who have undertaken tax reform to reduce gender bias).

4. Leslie A. Whittington, updated by James Alm, *Marriage Penalty*, in THE ENCYCLOPEDIA OF TAXATION & TAX POLICY 251, 252 (Joseph J. Cordes et al. eds., 2d ed. 2005).

5. Zelenak, *supra* note 2, at 365-66. On the other hand, couples, generally those with a primary earner, enjoy a marriage bonus of lower collective taxes because they benefit from larger joint filing tax brackets or larger exemptions. See *id.* at 340-41, 364 n.113. As discussed in Part III, some couples also enjoy bonuses with individual tax filing through tax planning.

6. Zelenak, *supra* note 2, at 365. See also *infra* Parts II, III.A.i.

encourage wives to enter the paid labor market or for higher-income husbands to shift property to their lower-income wives, in either case improving wives' economic position within marriage.<sup>7</sup>

Before 1970, only six OECD member countries taxed spouses separately which, by eliminating the combination of incomes, eliminated these marriage penalties.<sup>8</sup> The other countries shared the American system of taxing married couples as a unit.<sup>9</sup> By 1980, seven additional countries had adopted individual taxation, and three more did so in 1989 and 1990.<sup>10</sup> Because so many countries have changed how they tax married couples, there are many experiences the U.S. can study as it considers undertaking a similar change in policy.

In 1990, the United Kingdom (U.K.) completed its transition from imposing taxes on husbands and wives as a marital unit to taxing each spouse as an individual, so it has two decades of experience with the new regime.<sup>11</sup> Although the U.K. ought to be an obvious example for the U.S. if Congress decides to change its tax unit, little research has been done in the U.S., or made widely available to U.S. legal scholars, on the British transition.<sup>12</sup> This article fills this gap in knowledge as it evaluates behavioral responses to changing tax units, using the U.K. as a case study, and it discusses the implications for the U.S.

While this comparative method of learning from the experiences of one nation and applying that knowledge in another is used relatively infrequently by scholars, it has been used effectively in policy development. U.S. and U.K. policymakers have both looked across the Atlantic before adopting changes to

7. See, e.g., Blumberg, *supra* note 2, at 89–90; Christian, *supra* note 2, at 250; Gann, *supra* note 2, at 32–46; Gerzog, *supra* note 2, 36–37; Kornhauser, *supra* note 2, at 109–11; Zelenak, *supra* note 2, at 343; Richards, *supra* note 2, at 649–50.

8. See CONG. BUDGET OFFICE, *supra* note 1, at 59 app.A.

9. See *id.*

10. *Id.* at 59. Individual taxation is often limited to earnings. *Id.* In 1993, of 27 countries in the OECD, 19 countries taxed earned income separately but taxed couples' investment earnings collectively. *Id.* The Czech Republic adopted joint filing in 2005 only for couples with children. Jonathan R. Kesselman, *Income Splitting and Joint Taxation of Couples: What's Fair?*, IRPP CHOICES, Feb. 2008, at 3, 15.

11. Finance Act, 1988, c. 39, § 32 (Eng.). I have been asked why I did not use Canada as the comparison country. Although Canada has been studied in preparation for this article, it did not change tax units and so does not illustrate responses to change.

12. Economists have looked at the British transition's impact on transfers of property within the family. Melvin Stephens Jr. & Jennifer Ward-Batts, *The Impact of Separate Taxation on the Intra-Household Allocation of Assets: Evidence from the UK*, 88 J. PUB. ECON. 1989, 1990 (2004). See also ANN MUMFORD, TAX POLICY, WOMEN AND THE LAW: UK AND COMPARATIVE PERSPECTIVES 103–56 (2010). Mumford uses the move to individual taxation as her baseline and argues that the subsequent shift to a child-centered system hurts women. *Id.* at 109.

their tax systems.<sup>13</sup> In the future, the U.S. should use this approach in a careful and systematic way, focusing not only on what policies other countries have tried but also on the intended and unintended consequences of these policies and the likelihood of similar results in the U.S. As discussed in Part I of this Article, this type of deep research into a foreign country and its laws requires careful attention to the choice of comparison and a clear understanding of its limits. This Article sets forth guidelines for assessing the usefulness of international comparisons and what similarities two countries must have for the policy experiences of one to offer useful insights to the other.

With the differences between the two taxing regimes in mind, Part II explores how the U.K.'s approach to the tax unit evolved over time. Beginning with a discussion of the early development of the British income tax, this section examines why Parliament initially adopted a tax system that required husbands to file returns and pay taxes for the married couple, what I call husband taxation, and only incrementally recognized wives in the tax system. Part II then evaluates how and why the British Parliament adopted individual taxation or, as they call it, "independent taxation" in the Finance Act of 1988 that took effect in 1990.<sup>14</sup> The transition began in 1972 when Parliament introduced limited, optional individual taxation, permitting wives to file individual returns reporting their earned income and for taxes owed to be calculated as though they were single persons.<sup>15</sup> In 1988, Parliament went further and denied married couples the option to file jointly by adopting mandatory individual taxation.<sup>16</sup> Part III evaluates the consequences, some of which were unintended, of the U.K.'s adoption of individual taxation and considers what guidance the British experience can provide American

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13. One of the earliest, and possibly most important, comparative tax works is EDWIN R.A. SELIGMAN, *THE INCOME TAX: A STUDY OF THE HISTORY, THEORY, AND PRACTICE OF INCOME TAXATION AT HOME AND ABROAD* (2d rev. ed., 1921). For additional examples of non-academic comparative research in the policy context, see, for example, MARTIN DAUNTON, *JUST TAXES: THE POLITICS OF TAXATION IN BRITAIN, 1914–1979* 214–15 (2002); ANN MUMFORD, *TAXING CULTURE: TOWARDS A THEORY OF TAX COLLECTION LAW* 61 (2002); Steven A. Bank, *The Dividend Divide in Anglo-American Corporate Taxation*, 30 J. CORP. L. 1, 3, 33–34 (2004); Ajay K. Mehrotra, *Lawyers, Guns, and Public Moneys: The U.S. Treasury, World War I, and the Administration of the Modern Fiscal State*, 28 LAW & HIST. REV. 173, 212–13 (2010). See also *infra* notes 123–27 and accompanying text.

14. Finance Act, 1988, c. 39, § 32 (Eng.). Individual taxation differs from individual filing. Individual taxation calculates and imposes tax on each spouse separately. Individual filing merely requires each spouse to file a separate return and denotes nothing about how the tax is calculated. Therefore, individual taxation could be imposed but allow couples to file jointly (saving paper), or the system could allow spouses to file individually but be taxed jointly. Most proponents of individual filing in the U.S. also propose individual taxation.

15. See Finance Act, 1971, c. 68, § 23 (Eng.).

16. See Finance Act, 1988, c. 39, § 32 (Eng.).

policymakers. In doing so, it examines the incentives and behavioral responses created by individual taxation.

The Article concludes that the effects of the U.K.'s adoption of individual taxation should provide a warning to the U.S. Adopting individual taxation has created numerous unintended consequences in the U.K., and U.S. policymakers should consider these before changing the tax unit.<sup>17</sup> Even if adopting individual taxation proves to be the best choice, all of its results, both the good and the bad, need to be included in the political calculation. Looking carefully at the British experience with individual taxation can offer American policymakers invaluable guidance as they try to predict what the negative results will be.

### I. WHY THE U.K.? RULES AND REASON

Professor Mary Ann Glendon once wrote, "To many American lawyers, an interest in other legal systems is something like an interest in wines: a little knowledge about them is a sign of good taste and sophistication, but a serious dedication may be evidence of waste, or luxury, or even worse."<sup>18</sup> This attitude is caused by the often limited probative value of comparisons between legal systems: Relatively few international comparisons can offer policymakers meaningful practical insights into a particular issue.<sup>19</sup> Possibly for this reason, comparative tax studies often avoid applying concrete, specific lessons from one country to another.<sup>20</sup> Nevertheless, careful, informed comparisons between tax systems can be highly instructive and may even help policymakers shape policies that avoid the negative consequences other nations have experienced.<sup>21</sup>

17. See *infra* Part III (describing how individual taxation both led to wives' increased paid employment and property ownership and also created significant government policing problems due to new forms of tax avoidance).

18. Mary Ann Glendon, *Why Cross Boundaries?*, 53 WASH. & LEE L. REV. 971, 972 (1996).

19. See, e.g., Pechman & Engelhardt, *supra* note 3, at 21–22 (noting that large differences in the tax treatment of the family from country to country make it difficult to draw anything but general conclusions).

20. See, e.g., Louise Dulude, *Taxation of the Spouses: A Comparison of Canadian, American, British, French and Swedish Law*, 23 OSGOODE HALL L.J. 67, 127–28 (1985); Pechman & Engelhardt, *supra* note 3, at 21–22. But see Edward D. Kleinbard, *An American Dual Income Tax: Nordic Precedents*, 5 NW. J. L. & SOC. POL'Y 41 (2010) (arguing for schedular taxation based on evaluation of Nordic countries' tax systems).

21. For a discussion of comparative taxation, see HUGH J. AULT ET AL., *COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS* (3d ed. 2010) (offering comparative analysis of different tax structures); MUMFORD, *supra* note 12 (examining tax collection culture in the U.S. and U.K.); VICTOR THURONYI, *COMPARATIVE TAX LAW* (2003) (broadly discussing different tax structures); William B. Barker, *A Comparative Approach to Income Tax Law in the United Kingdom and the United States*, 46 CATH. U. L. REV. 7 (1996) (comparing the tax evolution in the U.S. and U.K.) [hereinafter Barker, *Comparative Approach*]; William B. Barker, *Expanding*

Policymakers that want to take practical lessons regarding the income tax from comparative tax studies need to ensure that they choose a comparison nation whose culture, politics, economy, and legal and revenue systems are similar to their own in certain fundamental ways. Although there will never be a perfect comparison, in order to be able to assess the likely consequences of a specific policy change the comparison should employ countries with key factors in common and clearly acknowledge where the countries differ.<sup>22</sup> Thus, broad threshold questions can eliminate many nations from consideration. Is there a genuine rule of law in both countries, and how strong are the legal institutions that regulate their income taxes? What are their relative levels of economic development, and are these levels so different that one can expect their income tax systems to differ accordingly? Is one or both of the nations constrained by supranational organizations that limit its individual sovereignty?

These threshold questions are easily answered for the nations under review.<sup>23</sup> Not only was the U.S. originally a colony of the U.K., but even after

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*the Study of Comparative Tax Law to Promote Democratic Policy: The Example of the Move to Capital Gains Taxation in Post-Apartheid South Africa*, 109 PENN. ST. L. REV. 703 (2005) (arguing that a comparative tax study should not be strictly theoretical but consider the nature of legislation); John C. Chommie, *Why Neglect Comparative Taxation?*, 40 MINN. L. REV. 219 (1956) (suggesting more avenues for comparative tax studies); Carlo Garbarino, *An Evolutionary Approach to Comparative Taxation: Methods and Agenda for Research*, 57 AM. J. COMP. L. 677 (2009) (discussing methods of comparative taxation); Anthony C. Infanti, *The Ethics of Tax Cloning*, 6 FLA. TAX REV. 251 (2003) (examining which ethical rules should apply to neutral experts when advising developing countries to adopt Western tax structures); Michael A. Livingston, *From Milan to Mumbai, Changing in Tel Aviv: Reflections on Progressive Taxation and "Progressive" Politics in a Globalized but Still Local World*, 54 AM. J. COMP. L. 555 (2006) (undertaking a comparative analysis of the effects of tax progressivity) [hereinafter Livingston, *From Milan to Mumbai*]; Michael A. Livingston, *Law, Culture, and Anthropology: On the Hopes and Limits of Comparative Tax*, 18 CAN. J. L. & JURISPRUDENCE 119 (2005) (exploring the potential for comparative tax study and why studies do not already exist); Omri Y. Marian, *The Discursive Failure in Comparative Tax Law*, 58 AM. J. COMP. L. 415 (2010) (examining existing comparative tax scholarship); John Tiley, *Judicial Anti-avoidance Doctrines: The US Alternatives*, 5 BRIT. TAX REV. 180 (1987) (considering introducing British general anti-avoidance rules to the U.S.).

22. I disagree with Watson that "[v]ariations in the political, moral, social and economic values which exist between any two societies" make it less worthy of drawing comparisons of legal problems. ALAN WATSON, *LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW* 4-5 (1974). See also RUDOLF B. SCHLESINGER ET AL., *COMPARATIVE LAW* 15, 50-52 (6th ed. 1998) (arguing that legal comparison is a useful method of study). While this article begins with a functionalist approach, one must examine the causes and effects of legal change with a critical eye in order to draw normative conclusions about those changes' consequences.

23. See Barker, *Comparative Approach*, *supra* note 21, at 8. However, the U.S. and U.K. are not in the same tax family, and some scholars worry about their differing ideological approaches. THURONYI, *supra* note 21, at 25-29; John Tiley, *Judicial Anti-Avoidance Doctrines: Corporations and Conclusions*, 4 BRIT. TAX REV. 108, 143 (1988).

gaining independence, the U.S. maintained legal and cultural ties with Britain. Today, the U.K. and the U.S. are both wealthy, industrialized democracies with common law backgrounds and robust, effective legal institutions, albeit with important differences in their law and politics that will be discussed below. Despite the U.K. being a member of the European Union, it retains substantial discretion in devising its own tax system as does, of course, the U.S.<sup>24</sup> Even when the U.K. responds to political pressures exerted by the European community, the British government must consider domestic reactions.<sup>25</sup> The U.S., on the other hand, has a federalist system that is likely to influence the effectiveness of changes in federal law as states can respond to national changes, as shown, for example, by states' adoption of community property laws to minimize federal taxes.<sup>26</sup> Therefore, although the initial threshold questions are met, there are important differences between the U.K. and the U.S. that need to be considered further.

Digging deeper, both to determine whether this comparison is genuinely worthwhile and to understand its limitations, we must look specifically at the American and British income tax systems. This examination focuses on five sets of questions. First, to what extent are both countries dependent upon the revenue generated by the income tax? The more a nation relies on its income tax, the stronger its interest will be in protecting its revenue-raising potential. Because the U.S. is reliant upon the income tax as a source of revenue, if the comparison country is not similarly dependent upon the income tax, the two nations are likely to have different concerns and, consequently, make different political choices.<sup>27</sup> Like the U.S., the U.K. relies heavily on the income tax, although the U.K. raises comparatively more revenue from internal taxes.<sup>28</sup> Despite its value-added tax (VAT), the British income tax fluctuated between 11.7% and 10.1% of the U.K.'s gross domestic product (GDP) and 39% and 30.9% of its tax revenue between 1970 and 1990, when most of the legal changes under review were adopted.<sup>29</sup> In the U.S., if individual taxation were

24. See EUROPEAN COMM'N, TAX POLICY IN THE EUROPEAN UNION 5 (2000).

25. As discussed *infra* 18–20, the U.K. often used European arguments to further purely local objectives.

26. See Stephanie Hunter McMahon, *To Save State Residents: States' Use of Community Property and the Federal System of Government for Tax Reduction, 1939–1947*, 27 LAW & HIST. REV. 585 (2009).

27. FIN. MGMT. SERV., DEP'T OF THE TREASURY, COMBINED STATEMENT OF RECEIPTS, OUTLAYS, AND BALANCES OF THE UNITED STATES GOVERNMENT 11 (2009), available at <http://www.fms.treas.gov/annualreport/index.html>.

28. See FISCAL AFFAIRS DEP'T, INT'L MONETARY FUND, TAX POLICY HANDBOOK 289–94 (Parthasarathi Shome ed., 1995).

29. *Id.* By 2005, the income tax in the U.K. was down to 28% of revenue. OFFICE FOR NAT'L STATISTICS, UK 2005: THE OFFICIAL YEARBOOK OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND 365 (2004).

to be adopted today, the income tax comprises less of American GDP, between 8% and 10%, but more of the government's tax revenue, approximately 42%.<sup>30</sup> Clearly, both nations rely on the income tax as a vital source of revenue, and so both have a strong incentive to consider carefully how any proposed change to the income tax would improve or worsen the tax's effectiveness.

The second set of questions relate to the political process of producing tax policy, as well as the resulting popular support for that policy. To what extent do each country's taxpayers and interest groups participate in the political dialogue that shapes tax policy? After policy is made, how aware are people of taxation, and how compliant are they in paying the tax? Despite their shared dependency on the tax, there are significant differences between the two countries under review in terms of the overall process of tax policy creation and the public's interest and involvement in that process. Unlike in the U.S., where tax policy typically develops in a complex, relatively public negotiation process involving both the executive and legislative branches of government, British policy development is more closed.<sup>31</sup> A substantially final, complete policy is designed by the British administration and then voted on (rather than negotiated) by Parliament.<sup>32</sup> Major British initiatives are often "announced in the annual budget speech of the Chancellor of the Exchequer as, in effect, *fait accompli*."<sup>33</sup> This is changing in the U.K. as policies are more open for debate but, compared with the U.S., the British executive retains the power over tax policy.<sup>34</sup>

Not only does this British practice result in less overt interest group pressure on the drafting of tax statutes, it has allowed the British government to design a simpler regime than exists in the U.S.<sup>35</sup> However, this lesser input by interest groups does not mean British taxpayers are more satisfied, or more compliant, with the resulting legislation. In fact, British taxpayers have a lower morale about their tax system than do their American counterparts.<sup>36</sup>

30. See FIN. MGMT. SERV., *supra* note 27, at 11; FISCAL AFFAIRS DEP'T, *supra* note 28, at 289-94.

31. For an example of the U.S.'s process, see Jackie Calmes, *Obama Weighing Broad Overhaul for Income Tax*, N.Y. TIMES, Dec. 10, 2010, at A1 (discussing negotiations between Democrats, Republicans, and the President regarding tax changes).

32. See DAUNTON, *supra* note 13, at 18-22; David W. Williams, *Taxing Statutes are Taxing Statutes: The Interpretation of Revenue Legislation*, 41 MOD. L. REV. 404, 405-06 (1978).

33. Michael Keen, *Peculiar Institutions: A British Perspective on Tax Policy in the United States*, 50 NAT'L TAX J. 779, 795 (1997).

34. *Id.* at 795-97.

35. See MUMFORD, *supra* note 13, at 117-26. Although the complexity of the British system has increased in recent years, it remains far less complex than the American system.

36. B. GUY PETERS, *THE POLITICS OF TAXATION: A COMPARATIVE PERSPECTIVE* 212-14 (1991); James Alm & Benno Torgler, *Culture Differences and Tax Morale in the United States and in Europe*, 27 J. ECON. PSYCHOL. 224, 239 fig.2 (2006). See also MUMFORD, *supra* note 13, at 51 (stating that eliminating ignorance about the British tax system would increase confidence

These differences in how the income tax is legislatively modified and how the public perceives the tax will affect the value of comparisons between the countries. Throughout this Article, the potential impact of these differences will be highlighted.

Third, in order to judge a comparison of income tax policy, we must ask: To what extent do the structure and practical administration of the two income taxes differ? Because this Article focuses on behavioral responses, are the differences substantial enough that we should expect similar policies to produce different results in practice? Answering these questions requires considering not only the general degree of complexity of the tax codes but also far-ranging and very specific details of their operation. For example, how do the countries define income? Do the variety and purpose of deductions differ? And to what extent are the taxes collected at the source of income? The answers to these questions reveal significant differences in the administration of the American and British income taxes but ones that can be defined and evaluated in the comparison process.

The U.K. has a schedular system of defining income in which the income and deductions from different sources are separately assessed, whereas the U.S. uses a global definition that combines all income and deductions in a single calculation.<sup>37</sup> One consequence that has evolved from these two approaches is that the U.K. has a more limited concept of income based on specific sources.<sup>38</sup> This is distinct from the broader, American concept that any realized increase in wealth is taxable income.<sup>39</sup> This difference causes the U.S. to be more inclusive when taxing income and the U.K. to be more limited and formulaic. Both nations, however, provide favorable tax rates for unearned income. In the U.S., capital gains rates are currently taxed at a maximum of 15% and, in the U.K., the comparable rate is 18%.<sup>40</sup> Both countries, thus, favor some forms of income over others.

How the nations collect these taxes also differs. The British system developed a pay-as-you-earn (PAYE) system instead of the American withholding and self-assessment regime.<sup>41</sup> The PAYE system tells taxpayers how much they owe, and it calibrates the amounts withheld over the course of

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in the system); William Gale, *What Can America Learn from the British Tax System?*, 18 FISCAL STUD. 341, 351 (1997) (noting the British citizenry's ignorance of their tax system).

37. I.R.C. §§ 61(a), 67–89 (2006); Comment, *Some Techniques of Taxation in the United Kingdom*, 52 YALE L.J. 400, 400–02 (1943).

38. See THURONYI, *supra* note 21, at 236–37.

39. *Id.* at 232, 236.

40. I.R.C. § 1(h) (2006); *Capital Gains Tax Rates and Annual Tax Free Allowances*, HM REVENUE & CUSTOMS, [www.hmrc.gov.uk/rates/cgt.htm](http://www.hmrc.gov.uk/rates/cgt.htm) (last visited Apr. 25, 2011).

41. AULT ET AL., *supra* note 21, at 163. The U.K. has required more self-assessment since 1996. *Id.*; Gale, *supra* note 36, at 350; Victoria Curzon Price, *The British Tax System: Opposing Trends*, 13 J. DES ECONOMISTES ET DES ETUDES HUMAINES 589, 592 (2003).

the taxable year to ensure that refunds or payments, and therefore the filing of tax returns, are generally not required.<sup>42</sup> Only about 9.3 million people are required to file a tax return in the U.K. each year.<sup>43</sup> Thus, only about 35% of British taxpayers, typically those who are self-employed or who have higher incomes or investment income, are required to file income tax returns.<sup>44</sup> In the U.S., conversely, more than 100% of taxpayers are required to file.<sup>45</sup>

The PAYE system works, in large part, because the British income tax is simpler than the American system, making self-assessment unnecessary in most cases.<sup>46</sup> In fact, simplicity in operation is an important policy goal in the U.K.; while the U.S. claims to have such a goal, little has been done to achieve it.<sup>47</sup> There are many fewer deductions and fewer rate brackets in the British income tax than in the American tax, and most British taxpayers are in one tax bracket, making the system resemble a flat rate tax.<sup>48</sup> In 2004, the latest year for which data are available, there were an estimated 29.9 million individual taxpayers in the U.K., of which only 3.4 million, or 11.4%, were not in the 20% bracket.<sup>49</sup> These structural differences between the U.K. and the U.S. will affect the impact of individual taxation, and the impact of these differences will be discussed later in this Article.

Fourth, to what extent does the enforcement of the taxes differ? Because simplicity is an important objective, the British income tax has less-developed

42. See Gale, *supra* note 36, at 347–50; Christopher C. Hood, *British Tax Structure Development as Administrative Adaptation*, 18 POL’Y SCI. 3, 14 (1985).

43. OFFICE FOR NAT’L STATISTICS, *supra* note 29, at 372. This does not mean the PAYE system is always accurate. One study notes at least 40% of taxpayers have incorrect codings. MUMFORD, *supra* note 13, at 54 n.4.

44. See OFFICE FOR NAT’L STATISTICS, *supra* note 29, at 372. Approximately 17 out of 26 million British individual taxpayers had no need to file tax returns, and 50% of those who need to file a return in the U.K. are self-employed. William J. Turnier, *PAYE as an Alternative to an Alternative Tax System*, 23 VA. TAX REV. 205, 224 (2003).

45. Americans who are not taxpayers have to file income tax returns because the system is also used to distribute government aid, such as the Earned Income Tax Credit. *E.g.*, I.R.C. § 6012(a) (2006).

46. See Gale, *supra* note 36, at 348.

47. DAUNTON, *supra* note 13, at 360; Gale, *supra* note 36, at 348–50.

48. OFFICE FOR NAT’L STATISTICS, *supra* note 29, at 372–73; Gale, *supra* note 36, at 347–48. There are three brackets in the British system, with 20%, 40%, and 50% rates. Finance Act 2010, c. 13, § 1 (Eng.). See also HM REVENUE & CUSTOMS, BUDGET 2009: ADDITIONAL RATE OF INCOME TAX AND INCOME-RELATED REDUCTION OF THE PERSONAL ALLOWANCE FROM 2010–11 1 (2009), available at <http://www.hmrc.gov.uk/budget2009/bn01.pdf>. There are also special rates for savings income or ordinary dividends. *Id.* at 2. Income tax rates in the U.S. are much more complex. I.R.C. § 1 (2006). The American alternative minimum tax with its flat tax features eliminates many of these deductions. See I.R.C. §§ 67, 68.

49. OFFICE FOR NAT’L STATISTICS, *supra* note 29, at 372–73.

anti-avoidance procedures than the U.S. has.<sup>50</sup> Instead of the common law doctrines and broad anti-avoidance legislation and regulations that U.S. regulators use to pursue tax avoiders whose actions breach the spirit, but not the letter, of the law, the British tax system demands that Parliament clearly define the income it wants to tax.<sup>51</sup> Therefore, British tax avoidance is largely a test of statutory construction and, to a certain extent, form over substance.<sup>52</sup> Taxpayers generally succeed in avoiding taxes if they structure their transactions to gain favorable tax treatment under the literal language, if not the intent, of the revenue statutes.<sup>53</sup> As discussed more fully in Part III, this difference in systems will have a definite effect on how effectively the government can police avoidance-driven transfers between spouses.

Finally, to what extent is each nation's income tax meant to further social goals, or goals other than raising revenue? The U.S. has long incorporated social policy goals in its tax code, for example through the adoption of numerous deductions and credits that attempt to encourage charitable donations, home ownership, secondary education, et cetera.<sup>54</sup> While the U.K. shares an understanding that the income tax can be used to implement social policy, it has never attempted to do so to the extent that the U.S. does.<sup>55</sup> Nevertheless, both nations generally share, and attempt to advance, the larger social policy goal of taxing people according to their ability to pay taxes; and both seek, within limits, to advance policies meant to achieve the dominant political party's vision of that end.<sup>56</sup> For example, the adoption of individual taxation in the U.K., as discussed in Part II, was not driven by revenue objectives but by social ones of providing financial support to one-earner families.<sup>57</sup>

The answers to these questions reveal important differences between the British and American tax systems in their structure and administration, and these differences will make comparisons of the income tax's tax unit between the U.K. and the U.S. less than perfect. However, these differences are a

50. HEATHER GETHING ET AL., HERBERT SMITH, GLEISS LUTZ, & STIBBE, A GENERAL ANTI-AVOIDANCE RULE FOR THE UK—THE FINAL CONFESSION OF GOVERNMENTAL INEPTITUDE? 2–4 (2010), available at [http://www.herbertsmith.com/NR/rdonlyres/04BC669D-20F7-4A4F-94E9-336A6D901397/0/8626\\_AntiAvoidanceRulebriefing\\_d4.pdf](http://www.herbertsmith.com/NR/rdonlyres/04BC669D-20F7-4A4F-94E9-336A6D901397/0/8626_AntiAvoidanceRulebriefing_d4.pdf). For a discussion of how British tax statutes are interpreted, see AULT ET AL., *supra* note 21, at 167–69, 205–08; THURONYI, *supra* note 21, at 172–84; Caroline Garnham, *Finance and the Family: The Pitfalls in Tax Planning*, FIN. TIMES (London), Oct. 9, 1993, at 10; Williams, *supra* note 32, at 408–17.

51. AULT ET AL., *supra* note 21, at 153, 167. A general anti-avoidance rule was proposed in the 1990s but withdrawn. *Id.* at 169.

52. *See id.* at 167–69.

53. *Id.* at 166, 169.

54. Gale, *supra* note 36, at 348–49.

55. *See id.*

56. *See id.*

57. *See infra* notes 186–87 and accompanying text.

matter of degree and not kind. If any comparison has value, these differences can be addressed by appropriate sensitivity to how they might affect the comparison. Moreover, for any comparison of a policy to be useful, it is important to identify and understand the factors that might cause the comparison to produce faulty advice and inaccurate predictions. Because the U.K., but not the U.S., has changed its tax unit to date, this Article addresses these questions by focusing on the actual experience in the U.K. and then considering the ways in which the U.S. experience would likely differ if it enacted a similar change.

This more narrow analysis of the specific policy must first ask: What were the stated goals of the policy change as articulated by both the government and various affected interest groups (recognizing that there are likely to be inconsistencies between these statements)? In the context of this article, the questions must be reframed to reflect the fact that the U.S. has not yet adopted individual taxation: What were the stated goals of the change in the U.K., and how would we expect those goals to differ if individual taxation was adopted in the U.S.? As a corollary to these questions, to what extent has the change achieved its stated goals?

Second, what impact has the change had on the operation of, and compliance with, the income tax? Has the change encouraged tax planning and tax avoidance? If a change in law significantly increases administrative costs or causes a substantial amount of tax avoidance, those considering a similar policy change should weigh that consequence against the change's benefits, both because governments are loath to spend money on tax enforcement and because the creation of tax avoidance, particularly to the extent it is visible to other taxpayers, might decrease compliance overall.<sup>58</sup> If there are factors that are likely to cause the administrative and compliance effects of a policy change to differ in the two nations under consideration, the comparison should identify them and weigh their likely impact.

Finally, what unintended consequences has the policy been shown to have? These consequences can be good or bad; the labels of good or bad themselves are socially constructed and, while society can agree on a few goals, many more divide the public. Nonetheless, although different people draw different normative conclusions about such consequences, identifying the unintended consequences of a policy change is useful when evaluating the overall success of the measure. Included in this group of concerns are the incentive effects of a change in policy. What does the change in legislation cause people to do? Although some incentives might be intended, that will not always be the case. It should never be assumed that all policymakers and advocates intended to create every incentive or even understood them.

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58. *See infra* Part III.B.

The remainder of this Article explores the answers to these questions in the case of the U.K.'s adoption of individual taxation and what that experience can tell American policymakers about the possible consequences of a similar policy change in the U.S. Although there are reasons to expect that the adoption of individual taxation by the U.S. would produce different results than it has in the U.K., the purpose of the previous questions is to help us predict when behavioral responses are likely to differ between countries.<sup>59</sup> This is not to suggest such a comparison will produce a perfect predictive guide. The effects of any policy change are complex because of the interaction of numerous political, social, and economic factors. Nonetheless, understanding the U.K.'s change in its tax unit should help American policymakers anticipate the behavioral responses of following in its footsteps.

## II. THE HOW AND THE WHY OF CHANGE

The U.K. originally adopted the income tax in the midst of the nation's wars with revolutionary France.<sup>60</sup> The tax was intended to raise much needed revenue for the war effort at a time when tax administration was rudimentary.<sup>61</sup> Consequently, administration was a significant concern; the tax's impact on wives was not. This early tax adopted husband taxation to make administration easier.<sup>62</sup> By requiring husbands to file tax returns reporting not only their income but also that of their wives, revenue was more easily raised. Through the first century of the tax's operation, the income tax all but ignored the existence of British wives. It was only gradually that Parliament enacted changes that granted wives rights and privileges within the tax system.<sup>63</sup> The pace of change began to accelerate in the 1970s and 1980s with the result that the original system was jettisoned for a mandatory individual regime.<sup>64</sup>

59. This is pushing the analysis further than Livingston, who claims that political differences will yield "indirect and unpredictable" results. Livingston, *From Milan to Mumbai*, *supra* note 21, at 583.

60. MARTIN DAUNTON, *TRUSTING LEVIATHAN: THE POLITICS OF TAXATION IN BRITAIN, 1799–1914*, at 32–57 (2001). For good descriptions of the early British income tax, see *id.* at 32–57; see generally ARTHUR HOPE-JONES, *INCOME TAX IN THE NAPOLEONIC WARS* (1939); B.E.V. SABINE, *A HISTORY OF INCOME TAX* (1966); Meade Emory, *The Early English Income Tax: A Heritage for the Contemporary*, 9 AM. J. LEGAL HIST. 286 (1965).

61. SABINE, *supra* note 60, at 26–27; Emory, *supra* note 60, at 288–89.

62. See ROYAL COMM'N ON THE TAXATION OF PROFITS & INCOME, SECOND REPORT, 1954, [cmd.] 9105, at 36 (U.K.) (noting that the treating husband and wife as one unit was easiest); *but see* Dulude, *supra* note 20, at 76 (noting the joint tax was instituted because women were thought to be servile to men).

63. See Dulude, *supra* note 20, at 76–79.

64. Finance Act 1988, c. 39, § 32 (U.K.); Dulude, *supra* note 20, at 77–79.

### A. *The Early Years*

By the end of the seventeenth century, the House of Commons had taken from the king his prerogative of economic regulation.<sup>65</sup> New political leaders, like Prime Minister William Pitt, held that power largely as a result of their financial acumen.<sup>66</sup> They were entrusted with the task of raising money even as war with France called attention to the incapacities of the British fiscal system.<sup>67</sup> Earlier revenue measures' susceptibility to evasion and their general unreliability forced Pitt to propose a new tax levied directly on income.<sup>68</sup> A significant concern for those drafting this income tax was how to minimize its avoidance.<sup>69</sup> They recognized that there would always be some avoidance and evasion, but they sought to confine the abuse within reasonable limits.<sup>70</sup> As a result, when, in 1798, they imposed a tax on a person's entire income, the person was not every individual but every non-married person and every husband.<sup>71</sup> Families were not to be a means of tax avoidance; couples were prohibited from reducing their taxes through the shifting of income to a lower-taxed spouse.<sup>72</sup>

Husband taxation was also a natural choice of tax units because it "afforded a convenient means of collecting the tax, more especially as the husband was a necessary party to any suit against his wife at common law."<sup>73</sup> At the time of the British tax's enactment, coverture denied British wives legal recognition as separate individuals from their husbands for most legal purposes.<sup>74</sup> From the early thirteenth century until the second half of the nineteenth century, English common law held that most of the property a wife owned as *feme sole* came under the control of her husband at the time of their

65. SABINE, *supra* note 60, at 14.

66. *Id.*

67. *Id.*; SELIGMAN, *supra* note 13, at 62.

68. 34 PARLIAMENTARY HISTORY OF ENGLAND col. 4-5 (London, T.C. Hansard 1819); SELIGMAN, *supra* note 13, at 72-73.

69. 34 PARLIAMENTARY HISTORY OF ENGLAND, *supra* note 68, col. 1152.

70. *Id.* col. 5.

71. Act of 1799, 39 Geo. 3, c. 41 (repealed 1816). The tax form specifically required husbands to include their wives' separate property. *Id.* c. 41. In 1803, a provision was added allowing wives acting as sole traders who did not live with their husbands to file separately. An Act for Granting to his Majesty, Until the Sixth Day of May Next After the Ratification of Definitive Treaty of Peace, a Contribution on the Profits Arising from Property, Professions, Trades, and Offices, 1803, 43 Geo. 3, c. 122, § 91, sch. D.

72. See SELIGMAN, *supra* note 13, at 103.

73. ROYAL COMM'N ON THE TAXATION OF PROFITS & INCOME, *supra* note 62, at 36.

74. J.H. BAKER, AN INTRODUCTION TO ENGLISH LEGAL HISTORY 550-51 (3d ed. 1990); 1 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND: A FACSIMILE OF THE FIRST EDITION OF 1765-1769 430 (University of Chicago Press, 1979); Mary Beth Combs, "A Measure of Legal Independence": The 1870 Married Women's Property Act and the Portfolio Allocations of British Wives, 65 J. ECON. HIST. 1028, 1032 (2005).

marriage.<sup>75</sup> While this was the general law of coverture, it did not apply in practice to wives of the wealthiest families or, as recent studies have shown, necessarily to any group of wives.<sup>76</sup> Wives along the income spectrum found means to preserve their separate property, owning and, more importantly, controlling that property.<sup>77</sup> A wife's separate property, for example if held in trust, could not be reached by her husband or by her husband's creditors.<sup>78</sup>

This economic reality sheds light on how coverture functioned in practice: It was a legal fiction regulating the relationship between society and the family more than an expected condition of marital relations. In other words, outsiders, and particularly the government, generally dealt with one member of the family even if within the family there were multiple decision-makers.<sup>79</sup> Under coverture, this one member was the husband. The British income tax continued the traditional coverture model, requiring HM Revenue & Customs (HMRC), at the time called Inland Revenue,<sup>80</sup> to collect only from husbands, even though husbands who paid significant income tax would likely have had wives with separate income beyond their husbands' reach on which they had to pay tax.<sup>81</sup>

Thus, husband taxation required that husbands pay tax on income that they neither owned nor controlled. Moreover, while husbands were legally responsible for reporting all of the couple's income, there was no means for legally compelling a wife to inform her husband of her sources or amount of income.<sup>82</sup> It is surprising that wealthy men, likely some in Parliament, did not

75. 1 LAWS RESPECTING WOMEN 151 (Oceana Publ'ns, Inc. 1974) (1777); *see also* BAKER, *supra* note 74, at 552.

76. Margot Finn, *Women, Consumption and Coverture in England, c.1760–1860*, 39 HIST. J. 703, 705–06 (1996).

77. BAKER, *supra* note 74, at 552–53; AMY LOUISE ERICKSON, *WOMEN AND PROPERTY IN EARLY MODERN ENGLAND* 150–51 (1993); R.J. MORRIS, *MEN, WOMEN AND PROPERTY IN ENGLAND, 1780–1870: A SOCIAL AND ECONOMIC HISTORY OF FAMILY STRATEGIES AMONGST THE LEEDS MIDDLE CLASSES* 233–38 (2005); TIM STRETTON, *WOMEN WAGING LAW IN ELIZABETHAN ENGLAND* 26–27, 119–23 (1998); Finn, *supra* note 76, at 705–06; Joanne Bailey, Comment, *Favoured or Oppressed? Married Women, Property and 'Coverture' in England, 1660–1800*, 17 CONTINUITY & CHANGE 351, 363–66 (2002).

78. Combs, *supra* note 74, at 1032–33 n.20.

79. EQUAL OPPORTUNITIES COMM'N, *INCOME TAX & SEX DISCRIMINATION* 7 (1978).

80. I have used HMRC throughout this article for consistency.

81. *See* ROYAL COMM'N ON THE TAXATION OF PROFITS & INCOME, *supra* note 62, at 36 (explaining how a husband would still be liable for a wife's earned income and investment income). It is beyond the scope of this article to examine early income tax records and trust and probate records to see how many husbands, in fact, paid tax on their wives' income. Although much of wives' property likely did not produce income, that was by no means always the case. MORRIS, *supra* note 77, at 254–63 (detailing the flow of income from womens' trusts).

82. EQUAL OPPORTUNITIES COMM'N, *supra* note 79, at 22. For at least one case in which a husband was jailed because he could not obtain information of his wife's income, *see* 64 PARL. DEB., H.C. (5th ser.) (1914) 2017.

draft the statute so that it taxed each spouse as an individual. This would have decreased their tax burdens and eliminated the situation of husbands being taxed on someone else's property. That they did not draft the law this way likely meant either: 1) Wives' trusts and other separate property meant little in practice, and husbands still felt they owned their wives' separate property; or 2) It seemed equitable to tax the couple on its combined income, as if their shared interests as a couple overrode the spouses' separate economic interests for purposes of taxation.<sup>83</sup> Regardless of which view prevailed, the first modern income tax taxed couples as a unit.

At the same time that the British income tax was proving that it could raise revenue, the women's movement began to win statutory advances in the law.<sup>84</sup> The Married Woman's Property Acts of 1870 and 1882 gave wives the right to own and control most forms of personal property as well as rights to their earnings.<sup>85</sup> One scholar has seen these acts as the "greatest transfer of resources from married men to married women which has ever taken place."<sup>86</sup> As these legal changes were altering the ownership of property within families, husbands continued to be responsible for the tax due on their wives' income, and husbands did not lobby to change this system.<sup>87</sup> Indeed, in the nineteenth century, "the principle of aggregation raised no issue of major importance."<sup>88</sup> Then, in the late nineteenth century, women, not their husbands, made individual filing, if not individual taxation, an important and recurrent issue as part of the women's rights movement.<sup>89</sup>

In time, Parliament began to recognize wives in the tax system, first by granting them their own exemption, or "allowance" as they are called in the U.K.<sup>90</sup> Previously, Parliament had given some married couples an additional exemption, the married man's allowance (MMA), only if the wife engaged in paid employment.<sup>91</sup> Although this meant that husbands already had larger

83. The latter position might also reflect the fact that tax rates were low.

84. For a discussion of the movement, see JAN PAHL, *MONEY AND MARRIAGE* 19–22 (1989).

85. Married Women's Property Act, 1870, 33 & 34 Vict., c. 93 (Eng.); Married Women's Property Act, 1882, 45 & 46 Vict., c. 75 (Eng.); see also PAHL, *supra* note 84, at 21–22.

86. PAHL, *supra* note 84, at 22.

87. *Id.* at 19–20.

88. ROYAL COMM'N ON THE TAXATION OF PROFITS & INCOME, *supra* note 62, at 36.

89. G.P. Marshall & A.J. Walsh, *Marital Status and Variations in Income Tax Burdens*, 4 BRIT. TAX REV. 236, 237 (1970).

90. REPORT OF THE ROYAL COMM'N ON THE INCOME TAX, 1920, [Cmd.] 615, at 56–57 (U.K.) [hereinafter REPORT OF THE ROYAL COMM'N]. An exemption is an amount of income not subject to tax. See I.R.C. § 151(a) (2006). I will call British allowances "exemptions" for the convenience of my audience.

91. REPORT OF THE ROYAL COMM'N, *supra* note 90, at 56–57 (describing the married man's allowance). After World War I, the husband received the MMA whether or not his wife engaged

exemptions than single taxpayers who received a single person's allowance (SPA), Parliament enacted an additional wife's earned income allowance (WEIA) that offset wives' wage income, income still reported by their husbands.<sup>92</sup> As the following chart shows, while a wife lost the SPA she had as an unmarried woman when she married, if she had earned income it was offset by the WEIA.<sup>93</sup> Because the SPA offset both unearned and earned income and the WEIA offset only earned income, the WEIA effectively reallocated the tax burden from earned to unearned income.<sup>94</sup>

British Pre-1990 Exemptions				
	SINGLE		MARRIED	
	Earned Income	Unearned Income	Earned Income	Unearned Income
WOMAN	Single Person Allowance (SPA)		Wife's Earned Income Allowance (WEIA)	N/A
MAN	Single Person Allowance (SPA)		Married Man Allowance (MMA)	

In 1914, Parliament further extended recognition to wives by giving them the option of separate filing.<sup>95</sup> Thereafter, wives could file individual returns. While this gave wives some independence from their husbands, the tax due was still calculated on the basis of the couple's total income.<sup>96</sup> The liability was then divided in proportion to each spouse's respective income.<sup>97</sup> Husbands could also make this election and might do so "to prevent a husband with a small income being liable for the tax on his wife's substantial

in paid employment. *Id.* See also Roger Kerridge, *Taxation and Marriage*, 47 CAMBRIDGE L.J. 77, 79 (1988).

92. See REPORT OF THE ROYAL COMM'N, *supra* note 90, at 56–57; EQUAL OPPORTUNITIES COMM'N, *supra* note 79, at 7–8. The value of the WEIA was raised to that of the SPA in order to induce women to enter the job market. *Id.* at 7.

93. EQUAL OPPORTUNITIES COMM'N, *supra* note 79, at 7. If a husband did not use all of the MMA, the remainder could be transferred and used to offset his wife's income; any of the WEIA not used against the wife's earned income was forfeited. See *id.* at 8.

94. See REPORT OF THE ROYAL COMM'N, *supra* note 90, at 56–57.

95. Finance Act, 1914, 4 & 5 Geo. 5, c. 10, § 9 (U.K.); REPORT OF THE ROYAL COMM'N, *supra* note 90, at 56–57.

96. REPORT OF THE ROYAL COMM'N, *supra* note 90, at 56–57. While spouses could elect individual filing, the system still imposed joint taxation, so the calculation of taxes due was based on spouses' combined returns. *Id.*

97. *Id.*

investment income.”<sup>98</sup> This option thus allowed spouses the independence of individual filing, but it did not allow them independence in their dealings with the government or reduce their marriage penalties. This option was not widely known and was rarely used.<sup>99</sup>

British women, unsatisfied with these modest gains, pressured the government to have the Royal Commissions convened in 1920 and 1954 consider individual taxation.<sup>100</sup> Recognizing that individual taxation would decrease the effective tax rates of wealthy couples because couples would shift income between spouses to maximize use of lower rate brackets, the Commissions did not find the urgings for individual taxation persuasive.<sup>101</sup> For example, the 1920 Commission wrote:

We feel that the demand of those who favour this change is in effect not so much a demand for separate assessment or separate recovery of tax—this they can have under the existing law—as for a diminution in Income Tax liability on the ground that part of the joint income happens to belong to the wife.<sup>102</sup>

The government estimated that the loss in revenue would be substantial: £20 million in 1920 and £143 million in 1954.<sup>103</sup> Moreover, according to both Commissions, families functioned as units and should be taxed as such.<sup>104</sup> Professor Lillian Knowles, the first female Professor of Economic History and the only woman on the 1920 Commission, issued a powerful dissent.<sup>105</sup>

While the U.K. was resisting change, many other countries were re-evaluating their tax units. The German Constitutional Court, in 1957, held that joint taxation of married couples imposed a higher tax on some married couples than if the spouses had not married, which violated constitutional

98. Mavis Moulin, *Taxmen Are Male and Chauvinists All*, GUARDIAN (Manchester), Mar. 2, 1974, at 19.

99. REPORT OF THE ROYAL COMM’N, *supra* note 90, at 57.

100. *See id.* at 57–58 (noting that there had been a “great deal of public attention” to the matter and that the committee interviewed numerous witnesses from women’s societies); ROYAL COMM’N ON THE TAXATION OF PROFITS & INCOME, *supra* note 62, at iii.

101. REPORT OF THE ROYAL COMM’N, *supra* note 90, at 57–58.

102. *Id.* at 58. *See also* ROYAL COMM’N ON THE TAXATION OF PROFITS & INCOME, *supra* note 90, at 36–37.

103. REPORT OF THE ROYAL COMM’N, *supra* note 90, at 58; ROYAL COMM’N ON THE TAXATION OF PROFITS & INCOME, *supra* note 62, at 37.

104. REPORT OF THE ROYAL COMM’N, *supra* note 90, at 57–58. *See also* ROYAL COMM’N ON THE TAXATION OF PROFITS & INCOME, *supra* note 62, at 36, 40–41. There was a sense in 1954 that any potential harm caused by aggregation was offset by the husband and wife’s exemptions. *Id.* at 36. If a husband who had income taxable at the basic tax rate was married to a woman with investment income and their joint income was below the surtax rate level, their tax bill would only be higher if the wife’s separate income was more than £90, a not insignificant amount in 1954. *Id.* If a wife’s income was earned, their combined tax bill would only be higher if their joint income exceeded the princely sum of £2,100. Oldman & Temple, *supra* note 3, at 589.

105. REPORT OF THE ROYAL COMM’N, *supra* note 90, at 151.

protections of marriage and the family.<sup>106</sup> This led the German government to adopt income-splitting joint filing which gave most married couples favorable treatment compared to their single counterparts.<sup>107</sup> On the other hand, while Canada had a system of individual taxation since its income tax was first introduced in 1917, both the Royal Commission on Taxation and the Royal Commission on the Status of Women unsuccessfully recommended the family as the tax unit.<sup>108</sup> The Royal Commission on Taxation, in particular, was troubled by the amount of tax avoidance perpetrated under Canada's individual system, even though the law purportedly denied recognition of transfers between spouses for tax avoidance purposes.<sup>109</sup>

The U.S. also engaged in these debates. When the modern American tax was first enacted in 1913, Congressman Cordell Hull of Tennessee contemplated requiring spouses to file jointly to prevent wealthy couples from using the family as a means of tax avoidance as they had during the Civil War, but Hull ultimately concluded that married women's property acts would make such a law unconstitutional.<sup>110</sup> As a result, Congress enacted a system that

106. Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] Jan. 17, 1957, ENTSCHIEDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVERFGE] 56, 1957 (Ger.); see also THURONYI, *supra* note 21, at 93. Courts in Cyprus, Ireland, Italy, Korea, and Spain have also held joint taxation unconstitutional. *Id.*

107. AULT ET AL., *supra* note 21, at 67.

108. See 3 ROYAL COMM'N ON TAXATION, REPORT OF THE ROYAL COMMISSION ON TAXATION: TAXATION OF INCOME 12–15 (1966) (Can.); ROYAL COMM'N ON THE STATUS OF WOMEN, REPORT OF THE ROYAL COMMISSION ON THE STATUS OF WOMEN 303–04 (1970) (Can.). Half of the federal Interdepartmental Committee on the Taxation of Women in 1975–1976 also wanted joint taxation. Dulude, *supra* note 20, at 84–85.

109. See Dulude, *supra* note 20, at 83–84. For a recent discussion of individual filing in Canada, with a sense of concern, see David G. Duff, Neuman and Beyond: *Income Splitting, Tax Avoidance, and Statutory Interpretation in the Supreme Court of Canada*, 32 CAN. BUS. L.J. 345 (1999) (examining a relevant case); Herbert J. Schuertze, *Income Splitting Among the Self-Employed*, 39 CAN. J. ECON. 1195 (2006) (estimating the amount of illegal income splitting in Canada); Frances Woolley, *Policy Forum: Liability Without Control—The Curious Case of Pension Income Splitting*, 55 CAN. TAX J. 603 (2007) (arguing for alternate measures to achieve the effect of income splitting); Lisa Philipps, *Income Splitting and Gender Equality: The Case for Incentivizing Intra-Household Wealth Transfers* (Comparative Research in Law & Political Econ. Law, Research Paper Ser. No. 04/2010, 2010) (examining how income splitting has expanded tax planning opportunities for spouses). There is a movement, at least among social conservatives, to allow more income splitting between Canadian spouses to aid one-earner families. See Kesselman, *supra* note 10, at 35; Jack Mintz, *Taxing Families: Does the System Need an Overhaul?*, INST. OF MARRIAGE & FAM. REV., Spring/Summer 2008, at 15.

110. ROBERT H. MONTGOMERY, FEDERAL TAX HANDBOOK SUPPLEMENT: 1941–42 § 1016 (1941). See also CONG. GLOBE, 38TH CONG., 1ST SESS. 2515–16 (1863) (stating that under the existing system wealthy individuals abused the tax system by dividing their income among their family members). Congress devoted little time to the specifics of the tax in 1913. See Stephanie Hunter McMahon, *A Law with a Life of Its Own: The Development of Federal Income Tax Statutes Through World War I*, 7 PITT. TAX REV. 1 (2009).

treated the individual as the basic unit for measuring the amount of federal income taxes owed.<sup>111</sup>

Many American groups looked to the U.K. in search of guidance on whether to change this tax unit, although Americans did not seem to be aware that British women had the option of individual filing and their own exemption for earned income.<sup>112</sup> In response to wealthy couples' tax avoidance, the Treasury Department often lobbied, unsuccessfully, for a mandatory joint system.<sup>113</sup> Women's groups, in particular the National Woman's Party (NWP), noted that British women protested mandatory joint taxation as discriminatory, and NWP voiced similar opinions when the Treasury Department made its proposals.<sup>114</sup> Dismissing claims that joint taxation discriminated against wives, Representative John Boehne of Indiana argued that the U.K. illustrated that it "does not invade the rights of a married woman. It treats her exactly in the same manner as her husband."<sup>115</sup> Representative Edith Rogers of Massachusetts and Representative Frances Bolton of Ohio responded that British law "ha[d] always been unfair to women."<sup>116</sup> As the U.K. noted in its 1954 Commission report, the U.S. responded to these debates by adopting the income-splitting joint return in 1948.<sup>117</sup>

Thus, countries including the U.K. and the U.S. debated the appropriate tax unit, but these debates often did not result in immediate legislative change. They also did not result in all countries agreeing on the same answer to the question of what constitutes the best tax unit. Instead, the adoption of individual taxation, in the U.K. at least, would require progress within the European women's movement and changing domestic economic circumstances to provide an environment in which individual taxation could be won. Until those changes came, many felt the original system, one that saw the family as a unit, was most fair.

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111. Tariff of 1913, ch. 16, § 2, 38 Stat. 114, 116 (1913).

112. See, e.g., H.R. REP. NO. 1040, at 64–68 (1941).

113. Stephanie Hunter McMahon, *To Have and To Hold: What Does Love (of Money) Have to Do with Joint Tax Filing?*, 10 NEV. L.J. 101, 115–21 (forthcoming 2011).

114. E. Mary Goodman, *British Women Urging Reform on Parliament*, ATLANTA CONST., Jan. 26, 1919, at A9; *An Englishman's Wife's Income*, EQUAL RTS., June 9, 1928, at 138; *Britain's Married Women Seek "Single" Tax Rating*, EQUAL RTS., May, 1942, at 39; *British Income Taxation Unequal*, EQUAL RTS., June 4, 1926, at 130; *British Women Phrase Demands*, EQUAL RTS., May 25, 1929, at 124; *Urges Separate Taxation for Married Persons*, EQUAL RTS., May 3, 1924, at 90; *Wives and Income Taxes*, EQUAL RTS., Mar. 20, 1926, at 42.

115. 87 CONG. REC. 6480 (1941).

116. *Id.* at 6600, 6715.

117. See Revenue Act of 1948, Pub. L. No. 80-471, §§ 301–303, 62 Stat. 110, 114–16 (1948); ROYAL COMM'N ON THE TAXATION OF PROFITS & INCOME, *supra* note 62, at 37.

*B. The 1970s: The Beginning of the End*

In the late 1960s and early 1970s, the U.K. joined in a feminist revival that swept across Europe at the same time that the nation enjoyed a period of relatively rapid economic growth.<sup>118</sup> As a result, British feminists added demands for financial and legal independence to their earlier critiques of the nation's policies.<sup>119</sup> There was a sense among these activists that the U.K.'s prosperity would allow the nation to provide this to its wives. British demands were reinforced by the European Community (EC) as it issued directives for economic equality.<sup>120</sup> By the 1970s, the EC included with this the adoption of individual taxation. "[E]qual treatment shall mean that there shall be no discrimination whatsoever on grounds of sex either directly or indirectly by reference in particular to marital or family status."<sup>121</sup>

Many countries heeded the EC's call; however, some countries had goals other than gender equality. For example, individual taxation was introduced in Sweden in 1971 and was coupled with the rapid expansion of subsidized childcare because Sweden wanted to incentivize wives to work in order to reduce immigration during a national labor shortage.<sup>122</sup> As a result of these changes, Sweden witnessed rising labor force participation by wives throughout the 1970s, but it was largely in part-time jobs.<sup>123</sup> Indeed, Sweden even experienced a flow of women from full-time to part-time work.<sup>124</sup>

Similar forces were at play in the U.K., where advances in women's rights were made but a reluctance to push the advances too far remained. A significant number of British women entered the paid labor market for the first time, but much of that increased presence was in part-time, insecure, and

118. Alexander Cairncross, *Economic Policy and Performance, 1964–1990*, in 3 THE ECONOMIC HISTORY OF BRITAIN SINCE 1700: 1939–1992, at 67, 67–70, 73–80 (Roderick Floud & Donald McCloskey eds., 2d ed. 1994); Miriam E. David, *Family Roles from the Dawn to Dusk of the New Elizabethan Era*, in REWRITING THE SEXUAL CONTRACT 17, 20 (Geoff Dench ed., Transaction Publishers 1999) (1997).

119. David, *supra* note 118, at 20.

120. EC Comm'n on Income Taxation, *supra* note 2, at 262; Council Directive 79/7/EEC, art. 1, 1978 O.J. (L 6) 24; Council Directive 76/207/EEC, art. 2, 1976 O.J. (L 39) 39; Council Directive 75/117/EEC, art. 1, 1975 O.J. (L 45) 19, 20.

121. Council Directive 76/207/EEC, *supra* note 120, at 39.

122. Anders Björklund, *Rising Female Labour Force Participation and the Distribution of Family Income—The Swedish Experience*, 35 ACTA SOCIOLOGICA 299, 299 (1992); Siv Gustafsson, *Separate Taxation and Married Women's Labor Supply: A Comparison of West Germany and Sweden*, 5 J. POPULATION ECON. 61, 63–64 (1992).

123. See Björklund, *supra* note 122, at 301, 304–05, 307 tbl.4; Rachel A. Rosenfeld & Gunn Elisabeth Birkelund, *Women's Part-Time Work: A Cross-National Comparison*, 11 EUR. SOC. REV. 111, 114 (1995).

124. Rosenfeld & Birkelund, *supra* note 123, at 114.

intermittent jobs.<sup>125</sup> While there was a seemingly dramatic growth in public approval for women in the workforce, this approval extended only, and extends today only, to women who did not have pre-school and school age children in the home.<sup>126</sup> Thus, by the 1970s, the public and most government policies were sensitive to gender issues, but this sensitivity was tempered by a reluctance to grant economic independence to the country's wives.<sup>127</sup>

Nevertheless, in 1971, British couples with two earners won the right for married women to be taxed as single individuals on their earned income.<sup>128</sup> Thus, two years before the U.K. entered the EC (but after the Conservative Party had regained control of the government), Parliament responded to domestic and European pressure and legislated that, if both spouses elected, a wife could be taxed separately on her wages; her unearned income still had to be reported by, and taxed to, her husband. There was a cost imposed on individual taxation that might have outweighed the economic and psychological benefits of separate status: the inability to claim the marital exemption, the MMA.<sup>129</sup> At the time, the MMA, at £600, was larger than the SPA, at £420.<sup>130</sup> For couples with two earners, the wife's exemption, the WEIA, of £420 was added on top of this larger MMA.<sup>131</sup> If a couple opted to be taxed separately as two single persons, for example if the wife earned enough income to benefit from double-dipping into lower tax brackets, the couple would lose the benefit of the difference between the MMA plus the WEIA (£1,020) and two SPAs (£840), or £180, of exempted income. In 1975, in couples where wives did work for wages, wives' income on average made up only 20.4% of the family's total income.<sup>132</sup> If couples filed separately, only

125. Jonathan Gershuny, *Sexual Divisions and the Distribution of Work in the Household*, in *REWRITING THE SEXUAL CONTRACT*, *supra* note 118, at 141, 142.

126. *Id.* at 141–42. The British Social Attitudes surveys conclude that a woman should work before they have children and after the children leave home, but only 1 in 20 think she should work if she has a preschool child, and 1 in 5 if she has school-aged children. Stein Ringen ed., *Family Change and Family Policies: Great Britain*, in *FAMILY CHANGE AND FAMILY POLICIES IN GREAT BRITAIN, CANADA, NEW ZEALAND, AND THE UNITED STATES* 29, 44 (Sheila B. Kamerman & Alfred J. Kahn eds., Family Change and Family Policies in the West Ser., 1997). Age is the most important predictor of these views, with those over sixty considerably more likely to think women should stay home. *Id.*

127. Amy Black & Stephen Brooke, *The Labour Party, Women, and the Problem of Gender, 1951–1966*, 36 J. BRIT. STUD. 419, 449–50 (1997); David, *supra* note 118, at 21, 38.

128. Finance Act 1971, c. 68, § 23, sch 4 (U.K.).

129. *Id.* See also John Jeffrey-Cook, *Separate Taxation of Wife's Earnings*, 6 BRIT. TAX REV. 439, 439 (1980).

130. Finance Act 1971, c. 68, § 33(2) (U.K.).

131. *Id.*

132. EQUAL OPPORTUNITIES COMM'N, *supra* note 79, at 51.

this portion of a couple's income would enjoy double-dipping in the wife's low tax brackets, often not enough to warrant the loss of the MMA.<sup>133</sup>

Shortly after this change in law, the U.K. entered the EC and, within the decade, the British economy plummeted.<sup>134</sup> After several major strikes, the government declared a state of emergency, and most of British industry was put on a three-day week.<sup>135</sup> Inflation ravaged the country, and unemployment steadily rose until 1977 and, although unemployment lessened somewhat from 1977 to 1979, it continued to rise until 1986.<sup>136</sup> By the late 1970s, top tax rates were as high as 98% in order to pay off a loan from the International Monetary Fund and, as an unintended, but not unexpected, consequence of the rate increase, tax avoidance was rampant.<sup>137</sup>

In this economic downturn, the British Equal Opportunities Commission (EOC) published a booklet entitled *Income Tax and Sex Discrimination*.<sup>138</sup> This independent, non-departmental public body complained that the HMRC did not advertise benefits, such as individual taxation, which would benefit wives.<sup>139</sup> Using excerpts from letters it had received, the EOC also illustrated that the system deeming a wife's income to be her husband's was regarded, "at best, as humiliating and, at worst discriminatory."<sup>140</sup> The anger was directed less at the economics of husband taxation than at its mechanics—wives would often receive letters from the HMRC about their jobs requesting their husbands send in corrected forms.<sup>141</sup> The EOC noted that women were frustrated that the Inland Revenue "persists in treating them as if they do not exist."<sup>142</sup> One woman later requested not individual taxation but, instead, that both spouses be required to sign a joint tax return in order to "ensure not only that the wife's status as an equal partner was recognised, but that she took her share in the joint financial chores."<sup>143</sup>

While the EOC promoted individual taxation, it also recognized that couples might use that system to reduce their taxes by shifting unearned

133. See Jeffrey-Cook, *supra* note 129, at 439.

134. Cairncross, *supra* note 118, at 68–71, 77–80.

135. *Id.* at 79–80.

136. *Id.* at 70.

137. *Id.* at 68–70, 83; Garnham, *supra* note 50.

138. EQUAL OPPORTUNITIES COMM'N, *supra* note 79. Private groups were also interested in the issue of family taxation. See INST. FOR FISCAL STUD., THE STRUCTURE AND REFORM OF DIRECT TAXATION 382–84 (2d impression 1978).

139. EQUAL OPPORTUNITIES COMM'N, *supra* note 79, at 3–4.

140. *Id.* at 4.

141. *Id.* at 7.

142. *Id.* For example, the general rule was to address correspondence to the husband, and to send rebates and bills to him, since he was legally liable for tax on both spouses' incomes. *Id.* at 19–20.

143. Mary Stott, *Carry on Fussing*, WOMAN'S GUARDIAN, May 17, 1973, at 9.

income between spouses.<sup>144</sup> Because this would be costly to the government, the EOC concluded that the income tax should continue to aggregate a married couple's unearned income for the determination of the applicable tax rates, but the amount of tax due should be apportioned and individual assessments issued.<sup>145</sup> The goal was to grant wives independence while preventing tax avoidance, a problem everyone at the time understood well.

In response to a deluge of more than 2,000 letters reacting to the EOC's report, the British government commissioned a green paper entitled *The Taxation of Husband and Wife*, released in 1980, the beginning of a decade in which policymakers would focus on cutting tax rates.<sup>146</sup> A green paper is a tentative, open-ended government report, and this one supported either of two courses of action: 1) allow spouses to choose between joint and individual taxation; or 2) change to a Canadian-style mandatory individual system.<sup>147</sup> The British government's efforts at tax reform stalled after publishing this paper.<sup>148</sup>

The U.S. did not adopt a similar method of partial individual taxation in the 1970s; instead, American policymakers focused on the interests of single taxpayers.<sup>149</sup> The need for some limitation on the burden shouldered by single

144. EQUAL OPPORTUNITIES COMM'N, *supra* note 79, at 29.

145. *Id.* at 29–30.

146. Dulude, *supra* note 20, at 77–78. *See also* CHANCELLOR OF THE EXCHEQUER, THE TAXATION OF HUSBAND AND WIFE, 1980, Cmnd. 8093 (U.K.); J.A. KAY & M.A. KING, THE BRITISH TAX SYSTEM 103 (5th ed. 1990). At least 730 of the letters demanded that the tax system treat married women as separate individuals. Dulude, *supra* note 20, at 77–78. There were four possibilities for how the tax system economically impacted married couples after 1972. First, if one person had earned income and the other had no income, the couple would be better off married; aggregation would be irrelevant but they would receive a MMA if the income was earned by the husband and, if it was earned by the wife, they would also receive a WEIA. Second, if both had income that collectively would be taxed in the lower tax bracket and the woman's income was earned, the couple would be better off married; aggregation would not push the couple into higher rate brackets and they would be entitled to the larger MMA plus the WEIA. Third, if their incomes would push them collectively into higher rate brackets and the woman's income was earned, the couple would be in exactly the same position as two single taxpayers because the spouses would opt for separate taxation. Finally, if the woman had investment income and either no earned income or less earned income than her exemption, the couple would be subject to extra tax when married because they would lose the woman's SPA to offset the unearned income. This latter scenario was the only time a couple was worse off economically with marriage. CHANCELLOR OF THE EXCHEQUER, *supra*, at 5–7.

147. CHANCELLOR OF THE EXCHEQUER, *supra* note 146, at 19, 24. Of 37 organizations that responded to the 1980 green paper, 4 favored retaining joint returns, 13 supported transferrable exemptions, and 29 used the opportunity to advocate giving additional financial assistance to families with children. PAHL, *supra* note 84, at 163–64.

148. Dulude, *supra* note 20, at 79.

149. Dennis Joseph Ventry, Jr., *The Treatment of Marriage Under the U.S. Federal Income Tax, 1913 to 2000* 421 (Sep. 2001) (unpublished Ph.D. dissertation, University of California-Santa Barbara).

taxpayers had been recognized almost from the income-splitting joint return's creation in 1948.<sup>150</sup> In response to public pressure, in 1951, certain qualified single persons with dependents were given one-half of the tax advantage enjoyed by married couples.<sup>151</sup> As the qualifications for this benefit were gradually loosened, broader discussions about the equity of denying single individuals equality with married couples continued.<sup>152</sup> Congress proposed 23 bills in 1967, 13 bills in 1968, and 61 bills in 1969 addressing this concern.<sup>153</sup> Instead of abolishing income splitting, these legislators wanted to nullify its impact by extending its tax savings to more taxpayers.<sup>154</sup> Political compromise produced the Tax Reform Act of 1969 that ensured all taxpayers filing as single individuals would not pay more than 120% of that paid by joint filers.<sup>155</sup>

Although the U.S.'s 1969 tax revision added a new tax penalty on marriage, by which two single persons both with taxable income could find their income tax liabilities increased if they married, it was argued to be "a necessary result of changing the income-splitting relationship between single and joint returns."<sup>156</sup> In 1972, the Assistant Secretary for Tax Policy acknowledged that the Treasury Department had known there would be the imposition of higher taxes on some married couples prior to the legislation's enactment and that Congress had been warned.<sup>157</sup> This warning does not seem to have stuck with politicians who claimed to be surprised when letters began pouring in complaining of the "marriage penalty."<sup>158</sup> Nevertheless, the

150. See, e.g., H.R. 1325, 81st Cong. (1949) (reducing tax obligations of widows and widowers). See also George F. James, *The Income of Married Couples: Is the Knutson Bill Justice?*, 26 TAXES 311, 366 (1948) (discussing the proposed change in treatment of widows); Frances M. Ryan, *Federal Tax Treatment of the Family*, 33 MARQ. L. REV. 1, 21–24 (1949) (discussing changes to federal tax law implemented by the Revenue Act of 1948). It was reported that Congress also began considering adjusting the rate schedule for married couples. *House Group Votes Down Tougher Tax Treatment for Married Couples*, WALL ST. J., May 9, 1951, at 6. They also considered deductions for war widows' child care expenses. *Would Aid War Widows*, N.Y. TIMES, May 7, 1948, at 20.

151. Revenue Act of 1951, Pub. L. No. 82-183, § 301, 65 Stat. 452, 480–83 (1951).

152. Ventry, *supra* note 149, at 298–330.

153. *Id.* at 342.

154. *Id.* at 426.

155. See Tax Reform Act of 1969, Pub. L. No. 91-172, § 803, 83 Stat. 487, 678–85 (codified as amended at IRC §§ 1–3 (2006)).

156. *Id.* § 803, 83 Stat. 487, 678; STAFF OF J. COMM. ON INTERNAL REVENUE TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969 10, 222–24 (J. Comm. Print 1970).

157. *Tax Treatment of Single Persons and Married Persons Where Both Spouses are Working: Hearing Before the H. Comm. on Ways & Means*, 92d Cong. 73–75 (1972) (statement of Edwin S. Cohen, Assistant Sec'y for Tax Policy, Dep't of Treasury).

158. Ventry, *supra* note 149, at 419.

immediate aftermath was largely a demand for still more help for singles.<sup>159</sup> In 1970 and 1971, members of Congress introduced seventeen and fifty-nine pieces of legislation, respectively, to equalize the income tax treatment of married and single taxpayers.<sup>160</sup>

Therefore, although in the late 1960s and early 1970s the U.S. and the U.K. both enacted legislation regarding the tax unit, the paths they chose were different and reflected different goals. As the U.K. was giving wives the ability to reduce their taxes by separately reporting their earned income and being taxed as single taxpayers on that income, the U.S. was providing tax cuts for single taxpayers and, as a result, began imposing a tax penalty on couples with two earners. While both approaches were adopted by conservative elements in their respective governments, their rhetoric reflected a different valuation of wives' employment.

### C. *The 1980s: The Time Is Now*

As the equal treatment of women gained greater popular acceptance in the U.K., the public bureaucracies overseeing the enforcement of the laws mandating that equal treatment were steadily losing popular support. When Margaret Thatcher became Prime Minister in 1979, she did so on a wave of criticism of statism.<sup>161</sup> Thatcher, like her American counterpart President Ronald Reagan, prioritized the reduction of the role of the state in the economy and re-focused attention on individual rights.<sup>162</sup> The new vision of the income tax was intentionally less redistributive and sought to stimulate the economy by reducing marginal tax rates and increasing exemptions.<sup>163</sup> As in the U.S. under Reagan, during Thatcher's tenure, there was a gradual economic recovery in the U.K. and a boom in the late 1980s.<sup>164</sup>

159. See, e.g., 118 CONG. REC. S35,988 (1972) (statement of Sen. Robert William Packwood); 118 CONG. REC. 16,117 (1972) (statement of Rep. Bella S. Abzug); 116 CONG. REC. H36,634–H36,635 (1970) (statement of Rep. Edward Koch); 117 CONG. REC. S3037–S3038 (1971) (statement of Sen. Abraham A. Ribicoff); 116 CONG. REC. 8442 (1970) (statement of Rep. William L. St. Onge).

160. Ventry, *supra* note 149, at 426.

161. David, *supra* note 118, at 21.

162. See *id.*; John Tiley, *United Kingdom*, in *FAMILY TAXATION IN EUROPE* 129, 131–32 (Maria Teresa Soler Roch ed., 1999).

163. See *ORG. FOR ECON. CO-OPERATION & DEV., THE OECD JOBS STUDY: TAXATION, EMPLOYMENT AND UNEMPLOYMENT* 45, 63–64 (1995). Tax rates rose steadily between 1973 and 1979 when rates halted. Price, *supra* note 41, at 592.

164. Lee Bawden & Frank Levy, *The Economic Well-Being of Families and Individuals*, in *THE REAGAN EXPERIMENT: AN EXAMINATION OF ECONOMIC AND SOCIAL POLICIES UNDER THE REAGAN ADMINISTRATION* 459, 482–83 (John L. Palmer & Isabel V. Sawhill eds., Changing Domestic Priorities Ser., 2d prtg. 1982); Cairncross, *supra* note 118, at 67.

In the early Thatcher era, wives' tax treatment continued to gain significant attention.<sup>165</sup> Most responses to the 1980 green paper favored individual taxation; they demonstrated widespread dissatisfaction with husband taxation largely because it was thought to deny women independence and privacy in tax matters and to impose a tax penalty on marriage.<sup>166</sup> On the heels of the green paper's publication, a widely-read survey circulated decrying the extent of sharing (or, more accurately, the lack of sharing) within marriage.<sup>167</sup> Professor Jan Pahl concluded that "there is a considerable amount of evidence to suggest that such sharing of income cannot be taken for granted."<sup>168</sup> Pahl found in the standard patterns of money management within marriage, wives came out the loser in control, discretion, and freedom.<sup>169</sup>

Nonetheless, British proponents of individual taxation could not win sufficient parliamentary support, in part because they could not agree how an individual-based system should operate.<sup>170</sup> In particular, they fought over how to reconcile the old exemption system with individual taxation. While many advocated transferable exemptions, so that if a wife had no income of her own her exemption could be used to offset her husband's income, others worried that this would dampen wives' incentive to work.<sup>171</sup> Critics argued that if a wife returned to work after a period of working at home, she would have to choose between leaving her exemption with her husband and paying more tax herself or taking back her exemption and increasing the tax imposed on her husband.<sup>172</sup> As many as 3.5% of wives engaged in paid employment at the time, totaling 200,000 women, would leave the labor force if given an exemption that they could transfer to their husband.<sup>173</sup> It was on that basis the House of Lords argued against transferrable exemptions.<sup>174</sup>

While mired in internal debates over the operation of individual taxation, the U.K. continued to face pressure from the EC to change its tax unit. The EC's push for greater equality between the sexes and favorable taxation for

165. Lorraine Fox Harding, "Family Values" and Conservative Government Policy: 1979–1997, in *CHANGING FAMILY VALUES* 119, 124 (Gill Jagger & Caroline Wright eds., 1999).

166. CHANCELLOR OF THE EXCHEQUER, *supra* note 146, at *forward*.

167. Jan Pahl, *Patterns of Money Management within Marriage*, 9 J. SOC. POL'Y. 313, 316 (1980).

168. *Id.* at 314. Pahl published a book on the topic in 1989. PAHL, *supra* note 84. Pahl has updated her studies in Jan Pahl, *His Money, Her Money: Recent Research on Financial Organisation in Marriage*, 16 J. ECON. PSYCHOL. 361 (1995).

169. *See* Pahl, *supra* note 167, at 320, 330, 333.

170. Dulude, *supra* note 20, at 78–79.

171. *Id.* at 78.

172. PAHL, *supra* note 84, at 164.

173. *Id.*

174. *Id.* at 165. The issue of transferrable exemptions was revived in the Conservative Party's 1997 Election Manifesto. Ruth Lister, *Promoting Women's Economic Independence*, in *REWRITING THE SEXUAL CONTRACT*, *supra* note 118, at 180, 267 n.11.

women focused on women's right to engage in paid labor.<sup>175</sup> Although British wives had the ability to be taxed separately on earned income, in a survey undertaken by the EC, 21% of those polled thought that income taxes might be discouraging wives from working.<sup>176</sup> This should have raised questions about how salient the issue of the tax unit was with taxpayers, but the survey neither distinguished between the incentive effects of tax rates and tax units nor discussed these different potential causes of wives' dissatisfaction with the tax system.<sup>177</sup>

This renewed European concern might have focused more attention on helping wives had many in the U.K. not experienced a deterioration in their economic circumstances and a backlash of social conservatism. While the 1980s were a period of economic growth, they were also a period of tremendous wealth polarization in both the U.K. and the U.S.<sup>178</sup> The gender pattern of employment also changed as businesses sought a more flexible labor market.<sup>179</sup> This benefited women and disadvantaged men, destabilizing traditional labor arrangements.<sup>180</sup> Because of changed labor patterns and significant, static levels of unemployment, the period was marred by poverty and social discontent.<sup>181</sup> As in the U.S., which faced similar pressures from

175. *Commission Proposal to Council for a New Community Action Programme on the Promotion of Equal Opportunities for Women*, at 18–19, COM (1981) 758 final (Dec. 9, 1981). See also *Commission Memorandum to Council on Income Taxation and Equal Treatment for Men and Women*, at 3, 12, COM (1984) 695 final (Dec. 14, 1984); Council Resolution on the Promotion of Equal Opportunities for Women, 1982 O.J. (C 186) 3; Resolution on the Position of Women in the European Community, 1981 O.J. (C 50) 35–36. The OECD was likewise active with respect to this issue. See ORG. FOR ECON. CO-OPERATION & DEV., *THE INTEGRATION OF WOMEN INTO THE ECONOMY* 137–41, 153–59 (1985) (noting that traditional tax structures disadvantage women in the labor market). Other groups concentrated on this issue as well: The International Labour Organization, Council of Europe, European Trade Union Confederation, European Youth Forum, Confederation of Family Organizations in the European Community, et cetera. *Commission Memorandum to Council on Equal Opportunities for Women*, at 6, (COM 1985) 801 final (Dec. 19, 1985) [hereinafter *Memorandum on Equal Opportunities for Women*].

176. HÉLÈNE RIFFAULT & JEAN-FRANÇOIS TCHERNIA, *COMM'N OF THE EUR. CMTY, EUROPEAN WOMEN IN PAID EMPLOYMENT: 1984* 19 (1984).

177. See *id.*

178. ORG. FOR ECON. CO-OPERATION & DEV., *supra* note 163, at 46.

179. Ros Coward, *Was Feminism Wrong about the Family?*, in *REWRITING THE SEXUAL CONTRACT*, *supra* note 118, at 64, 65–66.

180. *Id.* at 65–67.

181. See Peter Ingram et al., *Strike Incidence in British Manufacturing in the 1980s*, 46 *INDUS. & LAB. REL. REV.* 704, 704 (1993) (noting that one in forty bargaining groups went on strike in the 1980s); Interview by Sheila Rowbotham with Jean McCrindle, *More Than Just a Memory: Some Political Implications of Women's Involvement in the Miners' Strike, 1984–85*, *FEMINIST REV.*, Summer 1986, at 109, 117 (discussing how wives in mining villages who were unhappy with community conditions and poverty became involved in the strike efforts in order to improve conditions for their husbands and themselves); Clive Unsworth, *The Riots of 1981: Popular Violence and the Politics of Law and Order*, 9 *J.L. & SOC'Y* 63, 81 (1982) (noting that

de-industrialization, the troubled working class in the U.K. embraced family values as a source of security in an uncertain time.<sup>182</sup> This conservatism extended beyond the working class, and many of society's main concerns at the time were stable, heterosexual marriages with a gender division of roles and the support of these relationships by the government.<sup>183</sup> This reversed Britain's earlier ideological push to increase working wives' rights.<sup>184</sup>

In 1985, in the midst of this instability, the government commissioned a second green paper on the topic of individual taxation.<sup>185</sup> Unlike modern American advocates of individual taxation, the British government's focus was not on easing the tax burdens of two-earner couples.<sup>186</sup> Although the government also claimed to want to give wives privacy and independence in their tax matters, it primarily sought tax reduction for one-earner couples.<sup>187</sup> The Commission focused on families' life cycles and concluded that it was natural for a family to sometimes have one earner and, at other times, two.<sup>188</sup> The Commission thought husband taxation needed to be changed because it disadvantaged couples when they were likely to have only one earner, such as when they had young children.<sup>189</sup> The one-earner couples to benefit from this Commission's proposals were wealthy ones.<sup>190</sup> This formula for tax reduction would not reduce the tax burden of low-income couples who had no income to shift between spouses or of most two-earner couples because wives already had a WEIA equal to the SPA to exempt most, if not all, their wages.<sup>191</sup> Individual taxation, therefore, allowed the Conservative government to reinforce the traditional, primary-earner family for wealthy couples by cutting

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changing technology in the workplace will keep unemployment, and resulting discontent, high); *Victims of Thatcherism*, 20 ECON. & POL. WKLY. 1717, 1717 (1985) (noting high unemployment and resulting violence and unrest).

182. ALVIN Y. SO, SOCIAL CHANGE AND DEVELOPMENT: MODERNIZATION, DEPENDENCY, AND WORLD-SYSTEM THEORIES 238 (1990); Anne Barlow, *Regulation of Cohabitation, Changing Family Policies and Social Attitudes: A Discussion of Britain Within Europe*, 26 LAW & POL'Y 57, 60 (2004); Harding, *supra* note 165, at 119–20.

183. Harding, *supra* note 165, at 119.

184. *Id.*

185. CHANCELLOR OF THE EXCHEQUER, THE REFORM OF PERSONAL TAXATION, 1986, Cmnd. 9756 (U.K.). The government also sought to allow all exemptions be transferred between spouses in order "[t]o recognise the shared responsibilities of a married couple." *Id.* at 12.

186. *Id.* at 4–5.

187. *Id.* at 3, 5.

188. *Id.* at 5.

189. *Id.* at 5. There were no limitations proposed to ensure that favorable treatment would only help couples when they had young children or other care-giving responsibilities.

190. CHANCELLOR OF THE EXCHEQUER, *supra* note 185, at 3.

191. See *supra* notes 92–93 and accompanying text. Transferable exemptions might have reduced lower-income one-earner couples' tax burdens, but it failed to win parliamentary support. See *supra* text accompanying notes 170–71.

taxes and did so without increasing the size of the government, pleasing both the fiscally and socially conservative sides of the party.

While the 1986 green paper strongly supported individual taxation, as had prior government reports, it recognized that under such a system, many couples would have an incentive to rearrange their affairs to reduce their collective income taxes.<sup>192</sup> It concluded, however, that “[i]t is very unlikely that *all* couples would seek to rearrange the ownership of their income-bearing assets in order to take maximum advantage of separate tax rate bands. Many would not be able, or would not want, to make the necessary transfer of assets.”<sup>193</sup> It was estimated that if every couple able to take advantage of income shifting did so to the maximum extent, it would cost the government £100 million.<sup>194</sup> Consideration of whether Parliament would need to take steps to prevent this tax avoidance was deferred.<sup>195</sup>

The timing of the proposed change was crucial. The Commission knew it had to wait until the computerization of the PAYE system in 1988 before it could make such an extensive change.<sup>196</sup> Individual taxation would increase the number of taxpayers and require the coordination of family deductions.<sup>197</sup> Waiting, however, threatened the proposal. There was no assurance that the economic boom would continue or that there would not be a change in tax philosophy. Luckily for advocates of individual taxation, 1988 was a peak economic year.<sup>198</sup> Although 1988 was the end of post-war economic growth, the government retained the political capacity to change the tax unit and thereby meet its goal of helping one-earner couples while complying with European directives.<sup>199</sup>

The EC had once again demanded that “[t]ax discrimination should be examined with a view to arriving at a neutral system which does not act as a disincentive, particularly with regard to the taxation of the earnings of married women.”<sup>200</sup> The House of Lords understood that the EC also recommended a tax system that was neutral as between married couples where one spouse or both spouses were in paid employment.<sup>201</sup> The commentary provided by the House of Lords noted the seeming inconsistency in the EC’s objectives:

192. CHANCELLOR OF THE EXCHEQUER, *supra* note 185, at 26.

193. *Id.* (emphasis added). The government was also concerned that there would be “great practical difficulties in enforcing such special provisions.” *Id.*

194. *Id.*

195. *Id.*

196. *Id.* at 1.

197. See CHANCELLOR OF THE EXCHEQUER, *supra* note 185, at 12.

198. Charles Feinstein, *Success and Failure: British Economic Growth Since 1948*, in 3 THE ECONOMIC HISTORY OF BRITAIN SINCE 1700: 1939–1992, *supra* note 118, at 95, 95.

199. *Id.*

200. *Memorandum on Equal Opportunities for Women*, *supra* note 175, at 12.

201. O’Donoghue & Sutherland, *supra* note 2, at 568.

“Neutral” is here presumably intended to mean that one-earner and two-earner couples with the same total income should in principle pay the same tax. However, such neutrality can be guaranteed only under an *aggregate* taxation system. With *independent* taxation, the total tax depends on how the earnings are split. There thus appears to be a contradiction between the first part of the recommendation and the second.<sup>202</sup>

Without reconciling those two objectives, Parliament adopted mandatory individual taxation in 1988 to go into effect in 1990, so that all spouses were taxed separately on earned and unearned income.<sup>203</sup> Conservative Chancellor Nigel Lawson pushed hard for this change to the tax unit.<sup>204</sup> Perhaps counter-intuitively to American scholars, Margaret Thatcher herself did not support individual taxation, believing it would alienate working wives.<sup>205</sup> Because of the British system of exemptions, individual taxation would do little for most two-earner couples and provide a lot of tax-planning opportunities for one-earner couples.<sup>206</sup> Lawson was able to win this debate, over Thatcher’s objections, by demonstrating that individual taxation would ease unemployment by keeping wives out of the labor market.<sup>207</sup> This motive flew in the face of European directives even as it appeared to implement European policy.

The U.K.’s Parliament also recognized that individual taxation would cause some married couples to shift income between spouses to reduce their

202. *Id.* (quoting SELECT COMM. ON THE EUROPEAN COMITYS, COMMENTARY, 1985-6, H.L. 151, ¶ 31 (U.K.)).

203. Finance Act 1988, c. 39, § 32 (Eng.). This change allowed for confidentiality between spouses. Before the 1988 Act, a wife had to disclose to her husband her income in order for him to accurately complete the couple’s return, but a husband did not have to disclose his information to his wife. Susan Himmelweit, *Making Visible the Hidden Economy: The Case for Gender-Impact Analysis of Economic Policy*, 8 FEMINIST ECON. 49, 61 (2002). Many lamented what this did for women’s bargaining position within marriage. *See id.* Since 1990, husbands are only able to find out about their wives’ tax affairs, and vice versa, if they are given written authority. *Independent Taxation Manual—IN3: Confidentiality*, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/manuals/inmanual/IN3.htm> (last visited Feb. 25, 2011).

204. NIGEL LAWSON, THE VIEW FROM NO. 11 814, 881 (2003). Lawson’s predecessor, Sir Geoffrey Howe, also wanted individual taxation. *Id.* at 882. When Lawson pushed for larger personal exemptions, he was troubled that couples with two earners would receive a higher exemption than those with only one earner. *Id.* at 881. Lawson wanted transferable exemptions to help one-earner couples, but he had to abandon transferrable exemptions because the HMRC did not have the capacity to handle them until 1993, which would have been after another general election. *Id.* at 883, 885. Some women thought the transferrable exemption would require couples to share financial information, but Lawson thought “the wife for whom privacy was important could always purchase it cheaply enough by letting her husband keep the transferable allowance.” *Id.* at 884–85.

205. *Id.* at 882.

206. *See id.*

207. *Id.* at 884.

collective tax obligations.<sup>208</sup> There was debate on an amendment proposed by the Labour Party that would deny this tax result for gifts between spouses that were “undertaken with the sole or main objective of achieving a tax advantage.”<sup>209</sup> Norman Lamont, a Conservative member of Parliament, complained that this prohibition:

would undermine the very basis of independent taxation. If the amendment were carried, there would be no independence for married couples, nor would people be free to arrange their affairs as they wished . . . Independent taxation is bound to mean that some couples will transfer assets between them with the result that their total tax bill will be reduced. This is an inevitable and acceptable consequence of taxing husbands and wives separately.<sup>210</sup>

Thus, there was recognition in 1988 that some couples would use individual taxation for their own economic advancement, and that result was accepted by the Conservative government.

While individual taxation proved relatively easy to adopt in 1988, it remained difficult to adjust exemption levels. Exemptions are particularly important in the U.K. because the British government exempts significant amounts of income from tax.<sup>211</sup> In 1990, almost 25% of the gross earnings of the average single worker and 65% of those of the average married couple was exempted from tax, which amounted to 2.9, 3.7, and 4.5 times the relief given to single persons, married couples, and heads of households, respectively, in the U.S.<sup>212</sup> Due to the existing state of exemptions at the time Parliament was contemplating reform in the 1980s (and the fact Parliament was considering increasing exemptions), because two-earner families already enjoyed higher exemptions (the MMA plus the WEIA), a simple across-the-board increase in exemptions would have given two-earner couples 45% of the tax relief created by the measure.<sup>213</sup> This group constituted only 30% of taxpaying families.<sup>214</sup> As a result, Parliament adjusted exemptions to produce a more proportionate result. Specifically, it awarded each spouse a personal allowance (PA), equal to the former SPA, and the couple received a married couple’s allowance (MCA) equal to the additional amount previously received under the MMA.<sup>215</sup> Couples were therefore no worse off after 1990 than they had been before.

208. Anne Redston, *Income Sharing: The Nelsonian Option*, 2007 BRIT. TAX REV. 680, 682 (2007).

209. *Id.* (quoting Chris Smith’s proposed amendment to the Finance Act 1989, Section 109 relating to gifts between spouses).

210. *Id.*

211. Pechman & Engelhardt, *supra* note 3, at 3.

212. *Id.* at 3–4.

213. CHANCELLOR OF THE EXCHEQUER, *supra* note 185, at 10.

214. *Id.*

215. Finance Act 1988, c. 39, §§ 257, 257A (Eng.). Initially, the MCA was set against a husband’s income, but any unused portion could be transferred to the wife. *Id.* § 257D.

The MCA was not indexed to inflation, however, so it gradually decreased in real value over the 1990s.<sup>216</sup> In response to continued complaints that married couples were given favorable tax treatment compared to single taxpayers, the MCA was greatly reduced in scope such that only couples where one person had reached the age of sixty-five by April 2000 could take the allowance.<sup>217</sup>

As an aside, somewhat surprising given the current state of American politics, consideration of same-sex couples does not appear to have played much role in the British adoption of individual taxation. Individual taxation could have been used to make an intermediate concession to same-sex couples, putting them on the same footing as different-sex couples for tax purposes without legally recognizing their unions. However, in the late 1980s, the Conservative government could successfully ignore same-sex couples without making any such concession.<sup>218</sup> In fact, in 1988, Parliament referred to same-sex relationships as “pretended family relationships.”<sup>219</sup>

As in the U.K., the 1980s was a conservative period in the U.S. Like Thatcher, Reagan campaigned on a platform of tax reduction to stimulate economic growth.<sup>220</sup> One of Reagan’s first actions after taking office in 1981 was to slash tax rates.<sup>221</sup> Unlike the British, however, Reagan took specific steps to help two-earner couples, increasing the child and dependent care credit. This credit originated in 1954 as a deduction, was converted to a non-refundable credit in 1976, and increased in 1981 to be based on up to \$2,000 of the childcare expenses for one child and \$4,000 of those for two or more

216. *Id.* § 257A. See also Antony Seely, *Married Couple’s Allowance*, H.C. Library Standard Note SN/BT/870 3 (Oct. 19, 2009), <http://www.parliament.uk/briefingpapers/commons/lib/research/briefings/snbt-00870.pdf>.

217. Finance Act 1999, c. 16, § 31 (U.K.); see also Seely, *supra* note 216, at 3.

218. Brian Tobin, *Same-Sex Couples and the Law: Recent Developments in the British Isles*, 23 INT’L J. LAW, POL’Y & FAM. 309, 309 (2009).

219. Kenneth McK Norrie, *We Are Family (Sometimes): Legal Recognition of Same-Sex Relationships After Fitzpatrick*, 4 EDINBURGH L. REV. 256, 268 (2000). Until the mid-1990s, the U.K. took almost no action to recognize the rights of homosexuals but then, in 2004, Parliament passed the Civil Partnership Act that is to replicate the rights and obligations of marriage for same-sex couples. Carl F. Stychin, *Couplings: Civil Partnership in the United Kingdom*, 8 N.Y. CITY L. REV. 543 (2005); Andrew Flagg, Note, *Civil Partnership in the United Kingdom and a Moderate Proposal for Change in the United States*, 22 ARIZ. J. INT’L & COMP. L. 613, 614, 619–20 (2005). Same-sex couples still do not receive completely equivalent tax treatment; they are not entitled to the inheritance tax exemption married couples receive and are also disadvantaged with respect to the child credit. See WOMEN & EQUALITY UNIT, CIVIL PARTNERSHIP: A FRAMEWORK FOR THE LEGAL RECOGNITION OF SAME-SEX COUPLES 30 (2003), available at <http://www.equalities.gov.uk/pdf/Civil%20Partnership%20-%20a%20framework%20for%20the%20legal%20recognition%20of%20same-sex%20couples.pdf>.

220. Charles R. Hulton & June A. O’Neill, *Tax Policy*, in THE REAGAN EXPERIMENT: AN EXAMINATION OF ECONOMIC AND SOCIAL POLICIES UNDER THE REAGAN ADMINISTRATION, *supra* note 164, at 97, 98.

221. *Id.*

children.<sup>222</sup> Reagan's administration also added a dual earner deduction that was intended to, and did, increase the number of wives in the workforce.<sup>223</sup> Enacted in 1981, but repealed as part of the tax rate cuts enacted in 1986, the dual-earner deduction saved two-earner couples up to \$3,000 in taxes on the income of the lower-paid spouse.<sup>224</sup> While the U.S. took these small steps to help two-earner families in the early 1980s, it partially pulled back from these steps as its conservative economics became increasingly intertwined with socially conservative attitudes similar to those developing in the U.K.<sup>225</sup>

Therefore, although both countries experienced a decade of tax cuts and were generally conservative, only Parliament had enacted individual taxation by the end of the 1980s. As the U.S. began to help two-earner couples, as the British had in the 1970s, the British government adopted a policy that was intended to benefit one-earner families. Indeed, despite the fact that individual taxation had been a British feminist objective for more than a century, Parliament enacted individual taxation for reasons that were anything but feminist, seeking to help families economically while keeping women in the home. Highlighting this objective, the U.K. continued to aggregate couples' incomes to assess their eligibility for means-tested benefits and tax credits.<sup>226</sup>

222. I.R.C. § 214 (1954). The 1954 deduction was only available if it allowed the person taking it to earn income. *Id. amended by* Tax Reform Act of 1976, Pub. L. No. 94-455, § 504(a)(1), 90 Stat. 1520, 1563-64 (codified at I.R.C. § 44A), *superseded by* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 103, 95 Stat. 172, 187 (codified at I.R.C. § 44A). I.R.C. § 129 was also enacted in 1981, providing a dependent care exclusion for assistance provided by employers. Economic Recovery Tax Act of 1981, § 129(d)(1), 95 Stat. at 199 (codified at I.R.C. § 129(d)(1)). For a discussion of the tax treatment of childcare, see generally Allan J. Samansky, *Child Care Expenses and the Income Tax*, 50 FLA. L. REV. 245 (1998).

223. I.R.C. § 221 (1981) (incorporating Economic Recovery Act of 1981, Pub. L. No. 97-34, § 103, 95 Stat. 172, 187); Daniel R. Feenberg & Harvey S. Rosen, *Alternative Tax Treatments of the Family: Simulation Methodology and Results*, in BEHAVIORAL SIMULATION METHODS IN TAX POLICY ANALYSIS 7, 26-27 (Martin Feldstein ed., 1983); Gauff, *supra* note 3, at 435-36. The majority of the increase of women in the labor force was the result of increased participation, not increased hours, so it is likely that many women entered the market as part-time workers. Jerry A. Hausman & James M. Poterba, *Household Behavior and the Tax Reform Act of 1986*, J. ECON. PERSP., Summer 1987, at 101, 108.

224. I.R.C. § 221(b)(2) (1981) (incorporating Economic and Tax Recovery Act of 1981, Pub. L. No. 97-34, § 103, 95 Stat. 172, 187) (repealed by Tax Reform Act of 1986, Pub. L. 99-514, § 131, 100 Stat. 2085). For further discussion of Congress's original intent, see S. REP. NO. 97-144 (1981).

225. See, e.g., John L. Palmer & Isabel V. Sawhill, *Perspectives on the Reagan Experiment*, in THE REAGAN EXPERIMENT: AN EXAMINATION OF ECONOMIC AND SOCIAL POLICIES UNDER THE REAGAN ADMINISTRATION, *supra* note 164, at 1, 5 ("Embedded with this economic program was a fundamentally conservative social philosophy for the responsibilities of the federal government in promoting the general welfare and redressing inequalities among citizens and fiscal disparities among communities.").

226. Himmelweit, *supra* note 203, at 61. The U.K. also aggregates cohabitating couples' incomes for purposes of determining eligibility for means-tested benefits and tax credits. AULT

British women, nonetheless, welcomed individual taxation as a victory. Individual taxation was deemed to end an offensive “explicit sex discrimination.”<sup>227</sup>

### III. DAYS OF RECKONING

The years following the enactment of individual taxation were not kind to the British economy. The British pound was bound up in the EC’s European Exchange Rate Mechanism until its restrictions led to a run on the pound.<sup>228</sup> On Black Wednesday, 1992, Britain liberated its currency, but by then the Conservative Party’s credibility for managing the economy was destroyed.<sup>229</sup> Much as the nation had second thoughts about European exchange rates, it also reassessed the value of individual taxation, in part because “virtually all the financial benefit went to the relatively wealthy.”<sup>230</sup> Nonetheless, the repeal of individual taxation has not been seriously entertained.<sup>231</sup> The new tax unit appears to be here to stay.

This Part focuses on two ways people in the U.K. have altered their behavior in response to the adoption of individual taxation. First, it looks at the incentive effects individual taxation has had on British wives. In theory, it should have induced more wives to enter the paid labor market or, alternatively, encouraged husbands to shift the ownership of income-producing property to their wives. Both would result in more of couples’ income being taxed in the lower tax brackets of the country’s wives and would improve the relative economic power of wives. Second, this Part looks at how individual taxation encourages tax avoidance by higher-income spouses who do not want to reduce their control over the income they shift for tax purposes. Some higher-income spouses have sought to create new means of transferring tax ownership, but little else, to their lower-income spouses. In turn, this tax avoidance generates new pressures within the British tax system.

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ET AL., *supra* note 21, at 321; Barlow, *supra* note 182, at 68. See also Susan B. Boyd & Claire F.L. Young, *Feminism, Law, and Public Policy: Family Feuds and Taxing Times*, 42 OSGOODE HALL L.J. 545 (2004) (arguing feminists have little influence over British tax policy).

227. KAY & KING, *supra* note 146, at 43.

228. Larry Neal, *Impact of Europe*, in 3 THE CAMBRIDGE ECONOMIC HISTORY OF MODERN BRITAIN: STRUCTURAL CHANGE AND GROWTH, 1939–2000 267, 291–99 (Roderick Floud & Paul Johnson eds., 2004).

229. Matthew Tempest, *Treasury Papers Reveal Cost of Black Wednesday*, GUARDIAN.CO.UK (Feb. 9, 2005, 4:15 PM), <http://www.guardian.co.uk/politics/2005/feb/09/freedomofinformation.uk1>.

230. CEDRIC SANDFORD, WHY TAX SYSTEMS DIFFER: A COMPARATIVE STUDY OF THE POLITICAL ECONOMY OF TAXATION 59 (2000).

231. MUMFORD, *supra* note 12, at 127.

### A. *Power to the Women*

Individual taxation recognizes wives as autonomous individuals and provides means for reducing couples' collective taxes. As a result of the interaction of these two effects, many scholars expect individual taxation to produce significant changes in married couples' behavior.<sup>232</sup> Proponents of individual taxation argue that these changes will be socially desirable.<sup>233</sup> This section focuses on two of these changes: the increased paid employment of wives and their increased ownership of family property. While there is an expectation that individual filing will influence behavior, we should also be aware that, according to one survey, the majority of British citizens are generally ignorant of the legal rights established by marriage.<sup>234</sup> If British couples are also ignorant of their actions' tax consequences, this lack of awareness would reduce the incentive effects of individual taxation.

#### 1. *Employment of Wives*

As the 1986 green paper illustrated, Parliament assumed that wives would leave paid employment when they had children and that "the tax system should not discriminate against families where the wife wishes to remain at home to care for young children."<sup>235</sup> The government wanted to ensure that "[o]ne-earner couples at all income levels would see their tax burden fall substantially."<sup>236</sup> This section questions whether individual taxation had its intended result or whether it increased wives' paid employment in the U.K.—an unintended consequence for Parliament and some within the Thatcher administration.

There is an on-going academic debate whether individual taxation increases wives' incentive to engage in paid employment. Studies seek to

232. Research on changes in taxpayer behavior following changes in marital deductions and taxation of *inter vivos* gifts found that taxes do distort behavior. Alexander M.G. Gelardi, *The Influence of Tax Law Changes on the Timing of Marriages: A Two-Country Analysis*, 49 NAT'L TAX J. 17, 25 (1996); Katarina Nordblom & Henry Ohlsson, *Tax Avoidance and Intra-Family Transfers*, 90 J. PUB. ECON. 1669, 1669 (2006). In the late 1970s, Britain transferred the child allowance from husbands to wives, and some studies, but not all, found changes in behavior. Julie L. Hotchkiss, *Do Husband and Wives Pool Their Resources? Further Evidence*, 40 J. HUM. RESOURCES 519, 530 (2005); Shelly J. Lundberg et al., *Do Husbands and Wives Pool Their Resources? Evidence from the United Kingdom Child Benefit*, 32 J. HUM. RESOURCES 463, 479 (1997).

233. Lundberg et al., *supra* note 232, at 479.

234. Barlow, *supra* note 182, at 72–73. Psychological benefits might also have been reduced because the MCA was payable first to the husband, decreasing his tax burden relative to his wife's. See Finance Act 1988, c. 39, §§ 257, 257A (Eng.); FOREIGN & COMMONWEALTH OFFICE, BRITAIN 1991: AN OFFICIAL HANDBOOK 402 (1991).

235. CHANCELLOR OF THE EXCHEQUER, *supra* note 185, at 14–15.

236. *Id.* at 17.

determine whether the income tax, either the tax unit or tax rates, significantly affects women's employment decisions.<sup>237</sup> One study conducted in Sweden found that individual taxation encourages wives to provide more paid labor.<sup>238</sup> A second study, on the other hand, shows that women in countries with joint income taxation exhibit no statistically significant difference in their labor force participation than women in countries with individual taxation.<sup>239</sup> Yet another study concludes that, with individual taxation, "it is not safe to assume that labor supplies for different groups will change in the same direction."<sup>240</sup> If nothing else, the available evidence indicates that the issue of wives' workforce participation is complex, and it is unlikely that significant societal disincentives will be eliminated by changing the tax unit.

To date there is little research on the impact the adoption of individual taxation has had on British wives' labor performance. Because British wives previously had a separate exemption equal to that of a single person and the ability to be taxed separately on their earned income, economic disincentives were rare. They occurred where husbands or wives were unwilling to use individual taxation for earned income or where the impact of losing the MMA was greater than the reduction from having income taxed in lower tax brackets. On the other hand, because wives' exemptions are not transferrable, couples lose them if wives have no income; this should create some increased incentive for wives' paid employment. Similarly, non-economic disincentives were removed by the adoption of individual taxation. Although fewer than 35% of British taxpayers file a return, for those who are married, individual taxation means that wives no longer need to report their income to their husbands, unless the sharing of information is necessary to determine the deductions and credits that are still calculated on combined incomes.<sup>241</sup> But while individual taxation did create these additional incentives for wives to enter the work force, their effect was likely modest because the previous system in the U.K. was already relatively conducive to wives' employment.

The evidence that exists of British wives entering the paid labor force as a result of the change in the tax unit is inconclusive. Married women in the U.K.

237. Irene Dingeldey, *European Tax Systems and their Impact on Family Employment Patterns*, 30 J. SOC. POL'Y 653 (2001); Feenberg & Rosen, *supra* note 223; Gustafsson, *supra* note 122; A. Phipps & Peter S. Burton, *Social/Institutional Variables and Behavior Within Households: An Empirical Test Using the Luxemburg Study*, 1 FEMINIST ECON. 151 (1995); Rosenfeld & Birkelund, *supra* note 123; Nina Smith et al., *The Effects of Taxation on Married Women's Labour Supply Across Four Countries*, 55 OXFORD ECON. PAPERS 417 (2003); Tanja van der Lippe & Liset van Dijk, *Comparative Research on Women's Employment*, 28 ANN. REV. SOC. 221, 233 (2002).

238. Gustafsson, *supra* note 122, at 82.

239. Phipps & Burton, *supra* note 237, at 167.

240. Feenberg & Rosen, *supra* note 237, at 28.

241. See *supra* notes 44, 197, 203-04 and accompanying text.

have relatively small labor supply elasticities that have not been substantially changed by individual taxation.<sup>242</sup> Consistent with trends throughout Europe, as of spring 2004, 70% of British working-age women were employed, compared to 58% in 1984, and, as a result, the difference between the employment rate of men and women shrank from 19% in 1984 to 10% in 2005.<sup>243</sup> However, barely more than 60% of all British couples with children had two earners, and that number was only increased to 67% if there were no children.<sup>244</sup> More troubling, studies find that these numbers hide underlying flaws in the labor market that might have been exacerbated by individual taxation.<sup>245</sup> Of those couples with two earners, only 33.8% had both spouses working full-time and only 20.5% of couples with children under 15 had both spouses working full-time.<sup>246</sup> Only 8% of women working part-time said they did so because they could not find full-time work; 74% said they did not want to work full-time.<sup>247</sup>

Despite these feelings, part-time work is deleterious to women's long-term economic position as it does not provide many of the economic rewards of full-time employment, namely private pensions. In fact, studies show women who engage in predominantly part-time work for thirty years or more are not in any better financial position than those who are economically inactive.<sup>248</sup> And while the payoff of increased employment experience has risen for wives who work full-time, the pay penalty of part-time work has worsened.<sup>249</sup> Therefore, it is important to note that the combination of individual taxation and the flattening of the tax brackets encouraged wives to enter into less well-paid, less-secure, part-time employment when, and if, they needed additional income. These changes do not seem to have created the opportunities or motivation to seek out better paid, more secure, full-time alternatives.

While in the last two decades British wives have primarily entered part-time employment, there has nevertheless been a reaction against perceived governmental incentives for wives to enter the labor force. Some blame the tax system for creating, or at least acknowledging, changing family structures:

242. Stephens & Ward-Batts, *supra* note 12, at 1995.

243. OFFICE FOR NAT'L STATISTICS, *supra* note 29, at 143-44.

244. Dingeldey, *supra* note 237, at 663 (using data from 1996).

245. Because of individual taxation, wives have a lower effective rate of tax and, therefore, reap larger after-tax rewards for each dollar earned and might be satisfied earning fewer dollars.

246. Dingeldey, *supra* note 237, at 663 (using data from 1996).

247. OFFICE FOR NAT'L STATISTICS, *supra* note 29, at 145.

248. Tom Sefton et al., *Family Ties: Women's Work and Family Histories and Their Association with Incomes in Later Life in the UK* 15 (Ctr. for the Analysis of Soc. Exclusion, CASEpaper Ser., Discussion Paper No. CASE/135, 2008).

249. Hugh Davies et al., *Forgone Income and Motherhood: What do Recent British Data Tell Us?*, 54 POPULATION STUD. 293, 294 (2000).

Many see the new state libertarianism which has replaced [institutional support for the traditional family] not as a withdrawal of interference in private lives so much as the exercise of a new set of rules privileging a powerful interest group. This perceived new elite, which has definite “meritocratic” features, consists of professional “two-career” couples, who are better off when taxed as independent workers, plus a growing entourage of fellow-travelling adult “singles” whose relative affluence is similarly promoted by fiscal policies treating “family life” as an individual lifestyle choice.<sup>250</sup>

This backlash blames state policy for the fact that the nature of the family unit has changed. Twenty-nine percent of all children born in 1991, the year after individual taxation became effective, were born outside of marriage and, in 1991, 26% of households comprised just one person, compared with 17% in 1971.<sup>251</sup> We will have to wait to see whether individual taxation is blamed for changing family structures or celebrated for recognizing pre-existing social changes.

Whether a change to individual taxation would produce similar results in the U.S. is uncertain. In the post-World War II era, the U.S. also witnessed a growth in the percentage of wives entering paid employment.<sup>252</sup> With individual taxation, one would expect a greater degree of responsiveness in the U.S. because American wives have no earned income exemption equivalent to the WEIA or the British right to be taxed separately on earned income.<sup>253</sup> The greater economic incentive might be counter-balanced by the fact that women regard the U.S. joint return as less demeaning because both spouses, and not simply the husband, are required to file the couple’s tax return. Changing the British tax unit removed blatant discrimination in the administration of its income tax and might have produced a sense of equality and individual empowerment among wives unlikely to be experienced in the U.S. Therefore, the adoption of individual taxation in the U.K. might have had a larger psychological impact but less of an economic impact than a comparable change would have in the U.S.

250. Geoff Dench, *Nearing Full Circle in the Sexual Revolution*, in *REWRITING THE SEXUAL CONTRACT*, *supra* note 118, at 40, 41.

251. Ringen, *supra* note 126, at 39–40. Nonetheless, 41% lived in households that were composed of married couples with dependent children and only about 10% lived alone. *Id.* at 40. See also Harry Wallop, *Death of the Traditional Family*, *TELEGRAPH* (Apr. 15, 2009, 9:24 PM), <http://www.telegraph.co.uk/family/5160567/Death-of-the-traditional-family.html>.

252. U.S. CENSUS BUREAU, NO. HS-30, MARITAL STATUS OF WOMEN IN THE CIVILIAN LABOR FORCE (2003), available at <http://www.census.gov/statab/hist/HS-30.pdf>.

253. There is a capped childcare credit subject to a phase-out in the U.S. I.R.C. § 21 (2006). See also 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, 103–04 (1999) (explaining the child care credit).

At this time, only inconclusive evidence suggests American wives avoid entering the paid labor force because joint taxation imposes a higher tax burden on them as the secondary earner within married couples.<sup>254</sup> For example, if we view the primary earner as earning a couple's first dollar, thereby producing the income taxed in the couple's lowest tax brackets, then the secondary earner's first dollar of income would be taxed in the primary earner's top tax bracket.<sup>255</sup> But not all scholars agree that wives should be categorized as secondary wage earners. Lawrence Zelenak, for example, argues that most couples do not have the economic luxury to categorize wives as secondary wage earners.<sup>256</sup> Similarly, Dorothy Brown argues that this perspective of spouses' roles is held mainly by upper-income white families.<sup>257</sup>

Studies show that even among wives who are discouraged from working, the likelihood that joint taxation changes wives' behavior is less true today as more wives enter the labor force.<sup>258</sup> As of 2007, 57.6% of all married couples in the U.S. had two earners, and this is increasingly true for wealthier couples.<sup>259</sup> Other conditions, and other tax implications, counteract the disincentives created by joint taxation. A Congressional Budget Office report found that joint taxation leads the lower-earning spouse to work between 4% and 7% less than he or she otherwise would.<sup>260</sup> Therefore, the increase in wives' employment in the U.S. is not likely to be much greater than in the U.K.

254. See Cicconi, *supra* note 2, 260–64 (outlining recent studies of women's participation in the labor force). See also Francine D. Blau & Lawrence M. Kahn, *Changes in the Labor Supply Behavior of Married Women: 1980–2000*, 25 J. LAB. ECON. 393 (2007) (noting that reduced labor supply elasticities show government policies have a lesser distortionary effect on the quantity of labor supplied); Nada Eissa & Hilary Williamson Hoynes, *Taxes and the Labor Market Participation of Married Couples: The Earned Income Tax Credit*, 88 J. PUB. ECON. 1931 (2004) (finding the expansion of the Earned Income Tax Credit means 2% fewer wives are likely to enter the labor force); Bradley T. Heim, *The Incredible Shrinking Elasticities: Married Female Labor Supply, 1978–2002*, 42 J. HUM. RESOURCES 881 (2007) (concluding that wage and income elasticities for women have greatly declined); Chinhui Juhn & Kevin M. Murphy, *Wage Inequality and Family Labor Supply*, 15 J. LAB. ECON. 72 (1997) (finding wives of high-wage men increasing their employment more than wives of low-wage men); Thomas A. Mroz, *The Sensitivity of an Empirical Model of Married Women's Hours of Work to Economic and Statistical Assumptions*, 55 ECONOMETRICA 765 (1987) (concluding that tax rates have a small impact on the decisions of working married women); Nancy C. Staudt, *Taxing Housework*, 84 GEO. L.J. 1571 (1996) (arguing that women's labor decisions are less sensitive to tax changes in the face of increased labor participation).

255. Blumberg, *supra* note 2, at 53.

256. Zelenak, *supra* note 2, at 348–54.

257. Dorothy A. Brown, *Race, Class, and Gender Essentialism in Tax Literature: The Joint Return*, 54 WASH. & LEE L. REV. 1469, 1508–11 (1997).

258. See *supra* note 254.

259. U.S. DEP'T. OF LABOR, REPORT NO. 1018, WOMEN IN THE LABOR FORCE: A DATABOOK 76 (2009).

260. CONG. BUDGET OFFICE, *supra* note 1, at 12.

Unfortunately, conclusions about the impact a change in tax unit will have on wives' employment remain unsatisfying. There is some evidence, but not much, that British wives have responded to individual taxation by engaging in paid employment; however, their new employment appears to be in part-time work that continues to offer few of the benefits that full-time employment provides.<sup>261</sup> In the U.S., because fewer provisions exist to offset the disincentives of a secondary earner, there is likely to be a greater response to individual taxation unless the psychological impact of recognizing wives separately from their husbands was particularly large in the U.K. Without knowing the magnitude of this psychological impact, it is difficult to extrapolate exactly how individual taxation would affect wives' labor efforts in the U.S., other than to conclude it is unlikely to reduce them. Based on the British experience, policymakers should not expect a massive new entry of wives into full-time employment upon the adoption of individual taxation. More study needs to be performed to see who has entered the paid labor market and, to the extent possible, what motivated their entry.

## 2. Family Property Holdings

Before 1985, it was estimated that over half of all British wives owned some investment property, held independently or jointly with their husbands.<sup>262</sup> With the adoption of individual taxation, that percentage of wives and the value of what they owned was expected to increase.<sup>263</sup> Even Parliament expected families would react to individual taxation by shifting income between spouses in order to reduce couples' collective taxes.<sup>264</sup> In practice, this means that wealthier husbands should transfer investment property to their wives so that their wives could offset the income it generates with their exemption and pay tax on the remaining income in their lower tax brackets.

This shifting of family property was expected to occur despite drawbacks for the wealthier spouse. To be an effective transfer for British tax purposes, the transfer to the lower-income spouse must immediately divest the transferor's beneficial interest and vest that interest either in the transferee or in a valid trust for the transferee's benefit.<sup>265</sup> As in the U.S., whether a person has sufficiently "given" property to another is a matter of intention and a question of fact.<sup>266</sup> Unlike in the U.S., however, couples in the U.K. hold fewer easily transferred income-producing assets; more of a British family's

261. See Davies et al., *supra* note 249, at 294; Sefton et al., *supra* note 248, at 15.

262. CHANCELLOR OF THE EXCHEQUER, *supra* note 185, at 25.

263. See Stephens & Ward-Batts, *supra* note 12, at 1990.

264. See *id.* Not until 1991 could the personal exemption offset interest income. *Id.* at 1993.

265. 23(2) HALSBURY'S LAWS OF ENGLAND 365 (4th ed., reissue 2002).

266. *Id.* at 366. See also *Brennan Minors' Trustees v. Scanlan*, 9 T.C. 427, 434 (1925) (Eng.).

wealth is held in its home, as opposed to, for example, stocks or bonds.<sup>267</sup> British courts are also reluctant to recognize gifts between spouses for fear that the intent is to put property beyond the reach of creditors.<sup>268</sup> Therefore, transfers of income-producing assets should have a relatively greater impact on a higher-income British spouse, as compared to an American counterpart, as the British have fewer assets to transfer and must do so convincingly.

The potential tax savings from this income shifting is widely known in the U.K. and can be obtained with no tax cost, although administrative costs will almost certainly be incurred. In its manual on capital gains, the HMRC explains that a husband and wife or civil partners who are living together can transfer assets between themselves without triggering a capital gain or capital loss by completing, signing, and submitting a form indicating that there is a new owner of the property.<sup>269</sup> With some planning and the right kinds of assets, couples can minimize their collective tax obligations. This benefit is explained to couples in the popular press as “[t]he last remaining area where there is tax-favourable treatment for those who are married.”<sup>270</sup>

One study has examined the shifting of family assets between spouses with different marginal tax rates since the adoption of individual taxation.<sup>271</sup> This study found a sizeable shift in the incidence of taxable income; however, it also found that few couples shifted income to the optimal level.<sup>272</sup> In other words, most couples left some tax dollars on the table. Only 18% of couples shifted the optimal amount to the lower-income spouse if the husband’s tax rate was higher than the wife’s, and only 30% did so if the wife’s tax rate was higher.<sup>273</sup> But while the study found that couples would not shift income to the maximum extent possible to secure a tax reduction, it did find an increase in three outcomes: the proportion of wives having any investment income; the

267. James Banks et al., *Understanding Differences in Household Financial Wealth Between the United States and Great Britain*, 38 J. HUM. RES. 241, 246, 244 (2003).

268. GILLIAN DOUGLAS, AN INTRODUCTION TO FAMILY LAW 99–100 (Clarendon Law Ser., 2d ed. 2004) (2001).

269. CG22200—*Transfer of Assets between Husband and Wife or between Civil Partners Living Together*, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/manuals/cgmanual/CG22200.htm> (last visited Apr. 25, 2011). Individuals must not fall within any of the exceptions for nonresident spouses. CG22300—*Transfer of Assets between Husband and Wife or between Civil Partners: Avoidance: Nonresident Spouse or Nonresident Civil Partner*, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/manuals/cgmanual/CG22300.htm> (last visited Apr. 25, 2011). Spouses cannot transfer losses but they can transfer depreciated property before triggering the loss, and then trigger the loss. Finance Act 1988, c. 39, § 104 (Eng.); Taxation of Chargeable Gains Act, 1992, c. 12, §§ 3, 58 (Eng.).

270. Chas Roy-Chowdhury, *Would Getting Married Save You Tax?*, BBC NEWS (Apr. 6, 2006, 10:46 PM), <http://news.bbc.co.uk/2/hi/3472573.stm>.

271. Stephens & Ward-Batts, *supra* note 12, at 1989.

272. *Id.* at 2005.

273. *Id.*

fraction of household investment income owned by wives; and the fraction of households in which the wife held all of the investment income.<sup>274</sup> The authors concluded that a 10% differential in spouses' marginal tax rates led to a 2.6% to 3.1% increase in the share of investment income allocated to the spouse with the lower marginal tax rate.<sup>275</sup> This occurred despite the transaction costs of such re-allocations.<sup>276</sup> Based on this study, individual taxation does increase the wealth, if not the earning power, of British wives.

While transfers of income appear to benefit women, there are instances when women are, in fact, harmed. British husbands can transfer to their wives interests with sufficient restrictions attached to secure income tax savings but without transferring control.<sup>277</sup> Similarly, it is possible to give an interest in property that creates a joint ownership but not an equal ownership.<sup>278</sup> Nevertheless, the HMRC has created a default rule allowing spouses each to report 50% of the income of an asset held jointly regardless of actual ownership interests.<sup>279</sup> Tax advisors understand the rule's value for wealthy spouses: "This 50:50 rule is very useful if you wish to reduce you and your spouse's overall tax liability, but also retain much of the control over the underlying assets. You could put the assets in joint name, but only give away a 5% share of the investments."<sup>280</sup> This can create situations where wives are taxed on income they do not own and over which they have no control, even as it produces lower collective tax burdens. Although the author has found no cases to date, one can imagine that a spouse with such a 5% ownership interest but a 50% tax bill might object if the marriage ends in divorce. At that point, individual taxation might not seem so wife-friendly.

Similarly, family law might minimize the long-term impact of these tax-driven inter-spousal gifts. On one hand, in the event of a spouse's death,

274. *Id.* at 1990.

275. *Id.*

276. Stephens & Ward-Batts, *supra* note 12, at 1992.

277. 23(2) HALSBURY'S LAWS OF ENGLAND, *supra* note 265, at 341–42. Such interests have been developed and upheld in Canada. See Maureen Donnelly et al., *Income Splitting and the New Kiddie Tax: Major Changes for Minor Children*, 48 CAN. TAX J. 979, 985 (2000); Duff, *supra* note 109, at 346–47; Lisa Philipps, *Cracking the Conjugal Myths: What Does it Mean for the Attribution Rules?*, 50 CAN. TAX J. 1031, 1034 (2002).

278. 23(2) HALSBURY'S LAWS OF ENGLAND, *supra* note 265, at 341–42.

279. Income and Corporation Taxes Act, 1988, c. 1, § 283 (Eng.). See also *IN6—Separating the Couple's Affairs*, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/manuals/inmanual/IN6.htm>. Couples will only be taxed based on their actual interests if they file Form 17 indicating that desire. Income and Corporation Taxes Act, c. 1, § 283. This does not apply to family companies, in which case ownership is by interest. *IN129—Income from Jointly Held Shares in a Close Company*, HM REVENUE & CUSTOMS, [www.hmrc.gov.uk/manuals/inmanual/IN129.htm](http://www.hmrc.gov.uk/manuals/inmanual/IN129.htm).

280. Keith Gordon, *How to Save Tax as a Married Couple*, SCOTSMAN.COM (Aug. 24, 2004), [http://www.money.scotsman.com/scotsman/articles/articledisplay.jsp?section=Tax&article\\_id=991516](http://www.money.scotsman.com/scotsman/articles/articledisplay.jsp?section=Tax&article_id=991516).

surviving spouses in the U.K. do not automatically receive all of their spouses' property if there are other surviving relatives and, therefore, lower-income spouses might receive more total assets if they received part as *inter vivos* gifts from their higher-income mates.<sup>281</sup> On the other hand, because the amount a wife is entitled to on the death of an intestate spouse is tied to her maintenance, this favorable result might not always occur.<sup>282</sup> The earlier gift might simply reduce the amount a wife is entitled to on the death of her husband.

In the event of divorce, the effect of these gifts might also be minimized as a result of the liberalization of divorce law. Alimony and the division of family property are resolved in the U.K. in an application for ancillary relief after the divorce proceeding.<sup>283</sup> Likened to the War of the Roses, British couples fight over ancillary relief, in part because there are no hard and fast rules about how assets should be divided.<sup>284</sup> As described in the popular press, "When a married couple separates, all property – whether jointly owned or not – goes into one big pot of 'marital assets' to be divided up according to what the couple (and their lawyers) agree is fair."<sup>285</sup>

In the majority of divorce cases, British courts look at the financial need of the parties.<sup>286</sup> For those couples with more than a minimum of assets, judges retain discretion as to the division of assets; however, there has been a movement to a presumption of equality.<sup>287</sup> In 2000, in *White v. White*, the Law Lords stated that the starting position was an equal division of capital acquired during marriage, regardless of its ownership.<sup>288</sup> If a spouse wants an unequal division of the matrimonial assets, that spouse must show that he or she made an exceptional contribution to their acquisition.<sup>289</sup> Baroness Brenda Hale, in *Miller v. Miller*, concluded that it has become "less and less relevant to ask who technically is the owner of what."<sup>290</sup> Therefore, tax-driven gifts might also be accelerating the division that would ultimately be required by the

281. See DOUGLAS, *supra* note 268, at 210–12.

282. *Id.*

283. See *id.* at 188, 191.

284. DOUGLAS, *supra* note 268, at 190–93; Barlow, *supra* note 182, at 69; William Little, *Property and Divorce: How to Avoid the War of the Roses*, TELEGRAPH (Feb. 23, 2008, 12:01 AM), [http://www.telegraph.co.uk/property/3360512/Property-and-divorce-How-to-avoid-the-War-of-the-Roses.html#disqus\\_thread](http://www.telegraph.co.uk/property/3360512/Property-and-divorce-How-to-avoid-the-War-of-the-Roses.html#disqus_thread).

285. *How Does Divorce Affect Property Ownership*, GUARDIAN.CO.UK (Dec. 12, 2007, 1:46 PM), <http://www.guardian.co.uk/money/2007/dec/12/1>.

286. See Matrimonial Causes Act 1973, c. 18, §§ 23–25 (Eng.); Ira Mark Ellman, *Do Americans Play Football?*, 19 INT'L J.L. POL'Y & FAM. 257, 260–61 (2005).

287. DOUGLAS, *supra* note 268, at 189–90.

288. [2001] 1 A.C. 596 (H.L.) 605 (appeal taken from Eng.). See also *Miller v. Miller*; *McFarlane v. McFarlane*, [2006] UKHL 24 (H.L.) [16] (appeal taken from Eng.).

289. See *Cowan v. Cowan* [2001] EWCA (Civ) 679 [106], [2002] Fam. 97, 131 (Eng.); *Lambert v. Lambert*, [2002] EWCA (Civ) 1685 [46], [2003] Fam. 103, 123 (Eng.) A.C.

290. *Miller*, [2006] UKHL at [123].

family court upon divorce with the higher-income spouse losing control (if control is given) before a divorce necessitates that outcome.

The U.S. should experience similar, if not greater, instances of income shifting than have been witnessed in the U.K., similarly accelerating transfers on death or divorce.<sup>291</sup> In the period before the adoption of the income-splitting joint return, when the U.S. had an individual-based system, one commentator recognized that “[o]ne of the results of higher tax rates has been a burst of generosity on the part of prosperous husbands.”<sup>292</sup> More troublesome for the tax system, many of those transfers worked for tax purposes but gave wives little more than tax liability.<sup>293</sup> In one early case before the New York Court of Appeals, then-Judge Benjamin Cardozo complained that an assignment of a lease and the profits that it generated to a spouse was “to lower the plaintiff’s tax by taking income out of his return and adding it to the return to be made by his wife. Beyond that, the relation was to be the same as it had been.”<sup>294</sup> The difficulty of auditing these types of transactions and the resulting need to create default rules are as likely to trouble the U.S. as they do the U.K., and at least some American states will likely alter their marital property laws by adopting watered-down versions of community property laws, as they did before 1948, to permit a state-wide division of income without the need for individual devices.<sup>295</sup> Because the author can only hazard a guess at political responses, transfers of income-producing property will likely happen in the U.S., but we cannot fully predict the extent to which property and control over that property will be shifted.

The primary complicating factor for inter-spousal transfers, whether in the U.K. or the U.S., is that ownership and control issues within marriage are complex. Tax laws that promise tax reduction are unlikely sources for producing true spousal equality in property ownership. As with expected changes in wives’ paid employment, more information about the actual shifting of property, and confirmation that control as well as the tax obligation is being shifted, needs to be obtained before accurate calculations can be made about this consequence. However, while dangers lurk and the results are difficult to quantify, it is clear that individual taxation, properly policed, does encourage the redistribution of property within marriage.

291. The author has found no research on the percentage of American wives holding property.

292. Robert M. Yoder, *She’s Dear, But is She Deductible?*, SATURDAY EVENING POST, Oct. 12, 1946, at 17, 141.

293. See Randolph E. Paul & Valentine B. Havens, *Husband and Wife Under the Income Tax*, 5 BROOK. L. REV. 241, 255 (1936).

294. *Meinhard v. Salmon*, 164 N.E. 545, 549 (N.Y. 1928).

295. See McMahon, *supra* note 110.

### B. Tax Avoidance

The ability to shift income between spouses in different tax rate brackets, and thereby to reduce collective taxes, not only increases the relative economic position of British wives, but it also generates significant policing problems for the government. To the extent the government desires that only substantive changes in ownership produce favorable tax results, it needs to review the substance of those transactions. This policing requires costly effort and creates inequities between those caught devising sham transfers and those who manage to avoid detection. British courts have already begun hearing cases in which the HMRC contends that family income shifting constitutes tax avoidance and, therefore, the desired tax reduction should be denied.<sup>296</sup> This section examines these costs associated with inter-spousal income shifting.

#### 1. Unavoidable Complexity

In the years leading up to the adoption of individual taxation, tax avoidance in the U.K. was increasing.<sup>297</sup> Trying to negate that avoidance, the HMRC clawed back over £2 billion in unpaid taxes in 1988, compared to £1.68 billion in 1987.<sup>298</sup> Yet experts concluded that the HMRC was barely scraping the surface of the tax-avoidance problem.<sup>299</sup> The British government recognizes there is a gap between what people pay in taxes and what the government thinks they owe, estimated by the HMRC Revenue at £15 billion annually, but it is difficult for the HMRC to find this lost revenue because there are substantially fewer audits in the U.K. than in the U.S.<sup>300</sup> It will require a substantial infusion of resources to make this auditing possible, in part because the British system is less efficient than its American counterpart.<sup>301</sup> The HMRC's administrative costs, for example, are about 2% of revenue collected, which is three or four times the comparable figure for the I.R.S.<sup>302</sup>

While the U.K. recognizes that tax avoidance costs the government significant revenue, Parliament has nevertheless been slow to act. If the government attempts to police marital income shifting in order to distinguish true transfers from shams or to assess the value of transferred interests, there will need to be a significant revision of the existing simple regime to a more

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296. See, e.g., *Jones v. Garnett*, [2007] UKHL 35, (H.L.) [1]–[2] (appeal taken from Eng.).

297. Peter Rodgers, *Taxing Times for Fiddlers on the Hoof*, *GUARDIAN*, Sept. 1, 1989, at 25.

298. *Id.*

299. *Id.*

300. HM REVENUE & CUSTOMS, *MEASURING TAX GAPS 2009* (2010); THURONYI, *supra* note 21, at 213.

301. See Gale, *supra* note 36, at 349–50.

302. *Id.* at 350.

complex, American-style tax enforcement system.<sup>303</sup> This flies in the face of current British theory and policy objectives.<sup>304</sup> As discussed in Part I, the current British income tax has compromised in favor of simplicity even when it frustrates the goals of accurately measuring income or the ability to pay taxes.<sup>305</sup> A statutory general anti-avoidance rule has been discussed but no action taken because the British government is unsure if this new complexity would be an improvement over tax avoidance.<sup>306</sup> If there is increased tax avoidance as couples develop new ways to shift income for tax purposes, the U.K. will have a choice: either devote more resources to define and then police avoidance behavior or ignore the avoidance behavior.

The British government has tried to use existing law to prevent the inter-spousal income shifting that occurs through family businesses, but it has failed. The most notable case to date, *Arctic Systems*, resulted in a victory for married couples and a substantial loss for the HMRC.<sup>307</sup> The final decision ended a seven-year standoff between the government and Geoff and Diana Jones, the husband and wife owners of a small IT consulting firm, Arctic Systems Ltd.<sup>308</sup> After being let go from his job, Geoff decided to go into business for himself in 1992, two years after individual taxation was established.<sup>309</sup> On the advice of his accountants, the new company, owned equally by Geoff and Diana, paid Geoff and Diana salaries: Geoff's was below market for consulting work, and Diana's was for four or five hours per week of administrative and bookkeeping work.<sup>310</sup> After expenses and the corporate tax were deducted, the couple received the remaining income as dividends, which under U.K. law still

303. As discussed *supra*, Part III.A.ii., transfers of income-producing property, if legitimate, are recognized. The question is what constitutes a legitimate transfer.

304. See *supra* note 48 and accompanying text. The British government generally relies on taxpayers to self-report tax advantages, imposing on taxpayers part of the cost of reducing avoidance behavior. Lynne Oates & David Salter, *Disclosure of Tax Avoidance Schemes—Section 116 and Schedule 38*, 2008 BRIT. TAX REV. 505, 505. Family income shifting does not qualify under the rules provided for a reportable tax advantage. See *Guidance, Disclosure of Tax Avoidance Schemes*, HM REVENUE & CUSTOMS, <http://hmrc.gov.uk/aiu/suppguide.htm> (last visited Apr. 26, 2011) (outlining the hallmarks of transactions that must be disclosed).

305. See sources cited *supra* note 48 and accompanying text. The desire for simplicity means it is unlikely that a standard to police avoidance, as opposed to rules, would be adopted in the U.K.

306. THURONYI, *supra* note 21, at 185.

307. *Jones v. Garnett (Arctic Systems)*, [2007] UKHL 35 (H.L.) [28]–[31] (appeal taken from Eng.). See also Mr. P.A. Snell; Mrs. M. Snell v. Revenue & Customs Comm., [2008] S.T.C. (SCD) 1094 (Eng.) (appeal dismissed); *Campbell v. IRC*, [2004] S.T.C. (SCD) 396 (Eng.).

308. *Jones*, [2007] UKHL at [3]–[4].

309. *Id.*

310. *Id.* Diana Jones did not argue that she was paid in recognition of services performed in the home. See *id.* at [4].

minimized income taxes and national insurance contributions.<sup>311</sup> The government challenged this tax plan, arguing that Geoff never would have consented to transfer half of his business to a stranger under the same terms.<sup>312</sup> Attempting to apply a provision of a 1930 law intended to prevent transfers to minor children, the HMRC sought to tax all of the income generated by the business to Geoff individually.<sup>313</sup>

The lower courts agreed with the HMRC, disallowing the tax advantage from this planning.<sup>314</sup> On appeal, however, although the Law Lords believed that “[t]he decisions were tax driven and not commercially driven,” they concluded that the inter-spousal arrangement fell within the exemption provided for gifts between spouses.<sup>315</sup> This dividend system had secured a 16% tax reduction for the Jones, and this benefit applied to a large number of other couples’ dividend payment schemes.<sup>316</sup> During one hearing, the taxpayer argued that at least 200,000 families were potentially at risk of having their tax-planning devices invalidated; the government countered that the number was really closer to 30,000.<sup>317</sup> Regardless of how many couples stood to benefit, the Law Lords noted that gifts between spouses in the U.K. are not taxed, and these arrangements were, therefore, given tax effect.<sup>318</sup> Small businesses rejoiced: the chairman of a group of such businesses hailed the decision as “the best Christmas present for the U.K.’s small family businesses.”<sup>319</sup>

The government was not satisfied with this result, and HM Treasury sought its only recourse—to change the law. Treasury issued a written report to Parliament in mid-2007, proposing broad rules that would affect many limited companies and partnerships.<sup>320</sup> If two or more “connected persons,”

311. *Id.* at [5].

312. *Id.* at [8]. One commentator pointed out that if Geoff and Diana divorced, Diana’s claim to half of the business would be respected. Roger Kerridge, Note, *Jones v. Garnett (Arctic Systems): Another Way of Getting the Same Result*, 2007 BRIT. TAX REV. 591, 595.

313. *Jones*, [2007] UKHL at [2]–[3]; Finance Act 1988, c. 4, § 660A (Eng.). *See also* Kerridge, *supra* note 312, at 592.

314. *Jones v. Garnett*, [2005] STC (SCD) 9 (Eng.). *See also* Glen Loutzenhiser, Note, *Jones v. Garnett: High Court Gives Taxpayer the Cold Shoulder*, 2005 BRIT. TAX REV. 401, 403.

315. *Jones*, [2007] UKHL at [4], [10].

316. Robert Lee, *Lords Rules in Favour of Arctic Systems*, TAX-NEWS.COM (July 27, 2007), [http://www.tax-news.com/news/Lords\\_Rules\\_In\\_Favour\\_Of\\_Arctic\\_Systems\\_27983.html](http://www.tax-news.com/news/Lords_Rules_In_Favour_Of_Arctic_Systems_27983.html).

317. Loutzenhiser, *supra* note 314, at 410.

318. *Jones*, [2007] UKHL at [26]. *See also* Kerridge, *supra* note 312, at 593.

319. Alex Hawkes, *Arctic Systems: Timeline and Background on the Case*, ACCOUNTANCY AGE (Nov. 8, 2007), <http://www.accountancyage.com/accountancyage/specials/2149834/arctic-systems-geoff-diana>.

320. HM TREASURY, INCOME SHIFTING: A CONSULTATION ON DRAFT LEGISLATION 11–12 (2007), available at [http://www.hm-treasury.gov.uk/d/consult\\_income\\_shifting.pdf](http://www.hm-treasury.gov.uk/d/consult_income_shifting.pdf). The pre-budget reports are delivered every autumn to the Chancellor to the House of Commons. *Pre-*

which includes spouses, are engaged in business and the income the business produces is divided in a manner that produces a tax advantage, the division could be recharacterized.<sup>321</sup>

[T]he Government believes it is unfair for one person to arrange their affairs so that their income is diverted to a second person, subject to a lower tax rate, to obtain a tax advantage (income shifting). The vast majority of individuals cannot shift their income and income shifting runs counter to the principle of independent taxation.<sup>322</sup>

While the government indicated that it had no intention of attacking actual transfers between spouses, for example gifts of income-producing property, it found something fundamentally different in the business relationship of the Joneses.<sup>323</sup> Any arrangement like this, it felt, “minimises [sic.] their tax liability, and results in an unfair outcome, increasing the tax burden on other tax-payers and putting businesses that compete with these individuals at a competitive disadvantage.”<sup>324</sup> The Treasury then identified 85,000 small family-run companies and partnerships with arrangements similar to the Joneses.<sup>325</sup> It estimated that the elimination of these arrangements would save £200 million in administrative costs and prevent a tax loss of £350 million by 2010–2011.<sup>326</sup> Moreover, the government estimated that as the number of small businesses continues to increase, there will be more of these opportunities to shift income.<sup>327</sup>

Drafting a workable solution proved difficult, however. There were many attacks on the Treasury proposal as business groups rallied for its defeat. Arguing that it would disadvantage family-run businesses and discourage people from entering into business with anyone, spouses or not, pro-business groups sought to protect the financial advantages individual taxation could

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*Budget Report*, HM TREASURY, [http://www.hm-treasury.gov.uk/prebud\\_index.htm](http://www.hm-treasury.gov.uk/prebud_index.htm) (last visited Apr. 26, 2011).

321. *See id.*

322. HM TREASURY & HM REVENUE & CUSTOMS, 2007 PRE-BUDGET REPORT AND COMPREHENSIVE SPENDING REVIEW: PRESS NOTICES PN02 (2007), available at [http://www.hm-treasury.gov.uk/media/7/8/pbr\\_csr07\\_completepn.pdf](http://www.hm-treasury.gov.uk/media/7/8/pbr_csr07_completepn.pdf).

323. “The legislation is not intended to apply to genuine commercial arrangements, broadly where the share of overall income received by each individual is a fair and reasonable reflection of what they would be entitled to in a normal commercial arrangement, or where there is no overall tax advantage as a result of income shifting.” HM TREASURY, *supra* note 320, at 14.

324. 463 PARL. DEB., H.C. (6th ser.) (2007) 89–90 (U.K.).

325. HM TREASURY, *supra* note 320, at 34; Richard Tyler, *Arctic Systems and Income Shifting a Year On*, TELEGRAPH BLOG (July 21, 2008), [http://blogs.telegraph.co.uk/finance/Richardtyler/4678027/Arctic\\_Systems\\_and\\_income\\_shifting\\_a\\_year\\_on](http://blogs.telegraph.co.uk/finance/Richardtyler/4678027/Arctic_Systems_and_income_shifting_a_year_on).

326. HM TREASURY, *supra* note 320, at 34; Tyler, *supra* note 325.

327. HM TREASURY, *supra* note 320, at 3.

provide.<sup>328</sup> The Professional Contractors Group, who helped fund the *Arctic Systems* litigation, would not accept the “income shifting” label, arguing that for some years the government itself had recommended that businesses be set up jointly.<sup>329</sup> At least one pro-business organization “recognise[d] the Government’s concern, and [] accept[ed] that income-shifting is a legitimate area in which to seek policy changes where there is clear abuse”; however, it doubted that there was any “principled way of drawing a boundary between abusive and non-abusive tax planning in this area. . . . There is no point at all in asking the owners of small businesses to self-assess whether arrangements of the type with which this proposed legislation is concerned are arm’s-length.”<sup>330</sup>

Illustrating the growing power of British interest groups, last minute lobbying prompted the Chancellor to postpone the rule changes in favor of more extensive consultation.<sup>331</sup> Consequently, the final result after *Arctic Systems* remains uncertain. As it stands, these dividend-sharing arrangements effectively reduce a couple’s collective income taxes while the government continues to consult on this issue. Given the many other economic issues facing the U.K. today, the Treasury is unlikely to take action any time soon. It did not bring forward legislation on this topic in the 2010 finance bill.<sup>332</sup> The alternatives remain open: Parliament can pass a law moving to a more American-type, complex tax regime, allowing HMRC to police income-shifting behavior in order to evaluate on a case-by-case basis whether income has been unacceptably shifted by one spouse to gain a tax advantage, or

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328. See, e.g., CHARTERED INST. OF TAXATION, *INCOME SHIFTING: A CONSULTATION ON DRAFT LEGISLATION 2* (2008), available at <http://www.tax.org.uk/showarticle.pl?ft=id=6578;n=0;p=1>; INST. OF DIRS., *INCOME SHIFTING: A CONSULTATION ON DRAFT LEGISLATION 1-4* (2008); INST. OF CHARTERED ACCOUNTANTS IN ENG. & WALES, *TAX GUIDE, TAX FACULTY, INCOME SHIFTING: GUIDANCE ON DRAFT LEGISLATION 3* (2007), available at [http://www.icaew.com/index.cfm/route/153290/icaew\\_ga/en/Technical\\_and\\_Business\\_Topics/Faculties/News/Guidance\\_on\\_draft\\_income\\_shifting\\_legislation](http://www.icaew.com/index.cfm/route/153290/icaew_ga/en/Technical_and_Business_Topics/Faculties/News/Guidance_on_draft_income_shifting_legislation); PFK ACCOUNTANTS & BUS. ADVISERS, *INCOME SHIFTING: A CONSULTATION ON DRAFT LEGISLATION RESPONSE BY PFK (UK) LLP 1* (2008), available at [http://www.pkf.co.uk/pkf/download/business\\_tax/income\\_shifting\\_consultation\\_pkf](http://www.pkf.co.uk/pkf/download/business_tax/income_shifting_consultation_pkf); PROF’L CONTRACTORS GRP., *RESPONSE TO THE CONSULTATION ON “INCOME SHIFTING” DRAFT LEGISLATION 1* (2008), available at [http://www.pcg.org.uk/cms/index.php?option=com\\_content&view=category&layout=blog&id=665&Itemid=1093](http://www.pcg.org.uk/cms/index.php?option=com_content&view=category&layout=blog&id=665&Itemid=1093).

329. PROF’L CONTRACTORS GRP., *supra* note 328, at 6.

330. INST. OF DIRS., *supra* note 328, at 1, 4.

331. Tyler, *supra* note 325.

332. Finance Act 2010, c. 13 (U.K.). The government deferred action in 2009. HM TREASURY, *BUDGET 2009: BUILDING BRITAIN’S FUTURE*, 2009, H.C. 407-I, at 154 (U.K.), available at <http://www.official-documents.gov.uk/menu/com2008.htm>. As in the U.S., the focus has largely moved to offshore tax avoidance.

Parliament can allow *Arctic Systems* to stand and concede income shifting as couples desire.<sup>333</sup>

For all of its more complicated tax regime, we should not assume that the American system will be in a significantly better position to limit this type of tax avoidance, particularly as there is the possibility that all transfers of property between spouses, many of which are accepted by the British government, will be viewed as avoidance in the U.S., as they are in Canada. Moreover, even if one concedes—although this author is reluctant to do so—that the existing Internal Revenue Code could target every device wealthy spouses will use to shift taxable income, but not control over the underlying property, invalid transfers will still need to be caught. The I.R.S. is struggling to restrain today's tax avoidance and surely will have even more trouble with the detailed and complicated avoidance that might be perpetrated within couples.<sup>334</sup> Facially-valid avoidance devices like income-shifting arrangements will be difficult to detect, much less successfully prosecute. Economic pressure placed on the I.R.S. to prioritize enforcement of certain matters has already reduced enforcement in areas ripe for exploitation by income shifting.<sup>335</sup>

Perhaps more difficult to resolve, Congress will need to devise rules to reconcile individual taxation with the social provisions included in the American income tax. For example, rules will need to be created to deal with the income phase-outs applicable to many deductions and credits. To continue to base these tax expenditures on a family's aggregate income will be difficult to administer, but to allow each spouse to calculate them separately would sometimes produce incongruous results. Couples where the wealthy spouse refuses to, or is unable to, shift income to their lower-income spouse might enjoy tax benefits like the Earned Income Tax Credit, higher Child Care Credits, and more. While this might be an intentional result, these

333. As of 2005, Parliament requires an outright gift not subject to conditions in order to secure tax-free treatment. Income Tax (Trading and Other Income) Act, 2005, c. 5, § 626 (U.K.).

334. See McMahon, *supra* note 113; Theodore P. Seto, *The Unintended Tax Advantages of Gay Marriage*, 65 WASH. & LEE L. REV. 1529 (2008). For a discussion of American tax enforcement, see James Andreoni et al., *Tax Compliance*, 36 J. ECON. LITERATURE 818, 818–19 (1998) (analyzing the nature of tax enforcement and the structure of the I.R.S.); Steve Johnson, *The 1998 Act and the Resources Link Between Tax Compliance and Tax Simplification*, 51 U. KAN. L. REV. 1013 (2003) (arguing that simplifying the tax code would lead to increased tax compliance); Leandra Lederman, *Tax Compliance and the Reformed IRS*, 51 U. KAN. L. REV. 971, 982 (2003) (concluding that the IRS's softer approach has not netted increases in tax compliance); Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781 (2000) (examining the norms underlying American tax compliance and non-compliance behavior); David A. Weisbach, *Ten Truths about Tax Shelters*, 55 TAX L. REV. 215 (2002) (observing that no one change to the I.R.C. will eliminate the problem of tax shelters).

335. U.S. DEP'T OF THE TREASURY, FY 2010 BUDGET IN BRIEF 9, 60 (2009); IRS OVERSIGHT BOARD, ANNUAL REPORT TO CONGRESS 2008, at 25–31 (2009).

distributional and revenue effects should be included in our evaluation of individual taxation.

A similar concern involves the allocation of such social provisions. The British system has devised differing rules for allocating its various social provisions between spouses, although their administration should be easier because there are fewer such provisions in the U.K.'s tax. The British Children's Tax Credit, calculated on a couple's combined income, is allocated to the spouse who has income in higher tax brackets.<sup>336</sup> If neither spouse has income above the basic tax rate, they may share or allocate the credit as they desire.<sup>337</sup> Similarly, before the mortgage interest deduction was repealed, the system allowed spouses to choose how to allocate it, providing even more flexibility.<sup>338</sup> The deduction was not tied to which spouse actually paid the interest, although either spouse could withdraw their consent to the allocation.<sup>339</sup> This flexibility is not available for all British credits. The Blind Person's Allowance must first be applied against the total of the blind person's income before the excess can be transferred to a spouse or civil partner.<sup>340</sup> With many possible permutations of allocation available, American policymakers would have to decide whether to follow one of these paths for each credit or deduction granted.

These issues will inevitably create additional complexities in the tax system as taxpayers attempt to use the system to reduce their own tax burdens. Both the U.K. and the U.S. already struggle with tax avoidance and, in light of individual taxation's opportunities for increased avoidance, many of which will be substantial, evaluating the adoption of this regime should take into account the government's and taxpayers' logistical and financial constraints and responses.<sup>341</sup> The U.K. has begun to recognize the difficulty of removing

336. *Tax Credits, Child Benefit and Guardian's Allowance*, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/rates/taxcredits.htm> (last visited Apr. 26, 2011).

337. *Id.*

338. *IN1120—Interest Relief* (2009), HM TREASURY, INDEPENDENT TAXATION MANUAL, [http://www.hmrc.gov.uk/manuals/Inmanual/html/In0990/15\\_0041\\_IN1120.htm](http://www.hmrc.gov.uk/manuals/Inmanual/html/In0990/15_0041_IN1120.htm).

339. *Id.* If adopted in the U.S., this might encourage the sharing of financial information between spouses or, as the author suspects, the spouse in charge of financial affairs will make this determination for the couple.

340. *See Blind Person's Allowance*, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/incometax/blind-person-allow.htm> (last visited Apr. 26, 2011).

341. Leslie Book has argued, "policymakers concerned with cheating should pay closer attention to structural incentives and the relative ease in which individuals' non-compliance falls outside the light of day." Leslie Book, *Freakonomics and the Tax Gap: An Applied Perspective*, 56 AM. U. L. REV. 1163, 1167 (2007). *See, e.g.*, Johnson, *supra* note 334, at 1039–44 (examining the success of structural change components of the Revenue Reform Act); Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695 (2007) (advocating using third parties as a compliance tool); Edward J. McCaffery, *The Holy*

tax benefits once they have been enjoyed.<sup>342</sup> Unless the U.S. takes action to prevent similar results before it adopts individual taxation, it will be in no better position to eliminate the advantages once created, even as it struggles to devise new rules for the operation of existing tax policies.

## 2. Ignoring Bad Behavior

With individual taxation in place, the British government retains a choice, but one that it does not want to make. It can police inter-spousal income shifting at the cost discussed above, or it can grant tax reduction to all—even incomplete and entirely tax-driven—transfers of property, either by issuing a directive to that effect or by simply ignoring the behavior. This latter option would likely be based on the hope that existing rules prohibiting spouses, as connected persons, from engaging in certain obvious tax avoidance transactions are sufficient to police most avoidance behavior or that even purely tax-driven transactions will result in at least some property ending up in the hands of the nation's wives.<sup>343</sup> Parliament should be aware that if income shifting is permitted as a result of either of these approaches, it will have certain negative unintended consequences.

First, even if the British population concludes that the beneficial consequences of income shifting should override all else, this tax avoidance will decrease the taxes paid by those engaging in income shifting by decreasing the collective taxes that these married couples owe.<sup>344</sup> The British public is aware of this result as a strategy, but it is unclear whether they are aware of its larger implications.<sup>345</sup> Married couples are openly advised to

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*Grail of Tax Simplification*, 1990 WIS. L. REV. 1267, 1290 (arguing for a simplified tax system and considering why there is resistance to the idea).

342. James Chapman, *Cameron: I Don't Need a Coalition: Tories Would "Dare" Lib Dems to Vote Down Their Budget*, MAILONLINE (May 3, 2010, 10:39 AM), <http://www.dailymail.co.uk/news/election/article-1270459/David-Cameron-admits-facing-difficult-tough-decisions-spending-cuts-plug-163bn-deficit.html> (noting that on the eve of the last Prime Minister election, politicians were trying to reassure citizens that budget cuts would not remove tax credits for children, schools, or hospitals).

343. *IN8—Rules that do Not Change*, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/manuals/inmanual/in8.htm> (last visited Apr. 25, 2011).

344. Individual taxation, to the extent it lowers the taxation of married couples and necessitates increases in tax rates, will disadvantage those in relatively greater need. One-parent families, largely composed of women and children, constitute one of most rapidly-growing family types. Hilary Winchester, *Women and Children Last: The Poverty and Marginalization of One-Parent Families*, 70 TRANSACTIONS OF THE INST. OF BRIT. GEOGRAPHERS 70, 70 (1990). In Britain this group is extremely marginalized. *Id.* at 81. In the U.S., individual taxation might deprive this group of existing head of household benefits.

345. The most troubling aspect of the *Arctic Systems* income shifting might be the conversion of wage income to dividends which allows former employees to minimize their contributions to the health care system. CLAIRE CRAWFORD & JUDITH FREEDMAN, INST. FOR FISCAL STUD.,

decrease the amount they must contribute to the government by shifting property and the income it generates, but it is unclear whether people are aware that the combined result of these individual activities is estimated at £350 million annually.<sup>346</sup>

That income shifting decreases tax revenue also means that evidence of this behavior, even when the behavior is not undertaken for tax avoidance purposes, might become newsworthy. In fact, the argument that all income shifting constitutes tax avoidance quickly proved valuable as political ammunition. In May 1995, Labour seized upon news that leaders of the National Grid, the company that operates the national gas transmission system throughout Great Britain, “had avoided tax by transferring share options to their wives.”<sup>347</sup> As Prime Minister Tony Blair told the House of Commons, “The only reason why they transfer it to their spouses is because the remuneration [sic] is paid by way of share options to avoid income tax. That’s why they do it. That’s the issue.”<sup>348</sup> Similarly, Adam Inram, former Labour defense minister, earning more than £115,000 from outside business interests, recently made the news when he failed to declare a family firm that could be used in this manner to avoid tax.<sup>349</sup> How the public perceives this form of avoidance, and the degree to which they are willing to accept it, will play a part in the amount of damage it might do to the tax system as a whole.

The largest threat to the system might not be the revenue lost directly from income shifting but, instead, the publicity it receives which tacitly encourages other avoidance. Scholars have warned that if tax avoidance becomes part of everyday life, it will erode the U.K.’s tax-compliant culture.<sup>350</sup> As studies in other contexts have shown, the perception of widespread tax avoidance often reduces the compliance of taxpayers who were not previously engaging in tax avoidance because they begin to perceive the system as unfair.<sup>351</sup> The U.S.

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SMALL BUSINESS TAXATION 18 (2008); Anne Redston, *Small Business in the Eye of the Storm*, 2004 BRIT. TAX REV. 566, 569–71 (2004).

346. See, e.g., HM TREASURY, *supra* note 320, at 34; *Plotting That Tax Labyrinth*, FIN. TIMES, Jan. 4, 1997, at WEEKEND MONEY 5.

347. Roger Cowe, *Labour’s Tax Crusade Falts*, GUARDIAN, Dec. 10, 1997, at 12.

348. *Id.*

349. Jonathan Oliver & Georgia Warren, *Ex-Minister Fails to Declare Family Firm*, SUNDAY TIMES (London), Mar. 29, 2009, at 8.

350. Redston, *supra* note 345, at 580. See also KAY & KING, *supra* note 146, at 44.

351. See IRS OVERSIGHT BOARD, *supra* note 335, at 19 (finding it is important to taxpayers that the I.R.S. fairly enforce tax laws); Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453, 1497–99 (2003) (stating that punishing free-riders in the context of public goods may help maintain voluntary contributions); Redston, *supra* note 345, at 580 (quoting Simon McKie’s statement that it takes decades to convince people a system is fair and thereby get them to follow the rules); Steven M. Sheffrin & Robert K. Triest, *Can Brute Deterrence Backfire? Perceptions and Attitudes in Compliance*, in WHY PEOPLE PAY TAXES: TAX COMPLIANCE AND ENFORCEMENT 193, 194–95 (Joel Slemrod ed.,

government has found evidence that publicity of wealthy taxpayers' successful attempts to avoid their "fair share" of federal taxes undermines compliance throughout the income spectrum.<sup>352</sup> When people believe that others have manipulated the income tax regime, normally compliant taxpayers are tempted to do so as well.<sup>353</sup> The U.K. already has lower tax morale than does the U.S., so giving taxpayers additional motivation to avoid taxes could prove quite damaging.<sup>354</sup>

These potential reductions in revenue, both directly and through the erosion of taxpayer compliance, will damage the U.K.'s budget if receipt of the tax revenue has been assumed. In that case, the money will have to be found somewhere else, either by increasing taxes or by borrowing. Neither option is attractive, particularly during this economic downturn. To increase income tax rates will disproportionately affect those who choose not to, or are unable to, engage in tax avoidance. Alternatively, Parliament could increase other taxes. The most likely candidates would be increasing the British VAT, recently raised to 20% effective in 2011, or by increasing excise taxes.<sup>355</sup> These regressive taxes currently fund a quarter of the nation's revenue.<sup>356</sup> These alternatives will, in turn, produce new behavior of their own as taxpayers respond to the changing tax circumstances.

Of course, this problem is not unique to the U.K. or to individual taxation. To the extent that any tax provision provides taxpayers means to reduce their individual burdens, it runs the risk of requiring that the government increase tax revenue from other sources. The HMRC estimates that billions are lost every year because taxpayers evade the income tax; only part of that evasion comes from what the HMRC sees as impermissible income shifting.<sup>357</sup> Similarly, the U.S., without this opportunity for avoidance via income shifting, reports a \$345 billion gross tax gap.<sup>358</sup> Income shifting would likely increase this amount. When the U.S. had individual taxation, President Franklin D.

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1992) (noting that perception of general tax compliance is important to individual compliance decisions). *See also* sources cited *supra* notes 261, 267.

352. IRS OVERSIGHT BOARD, *supra* note 335, at 19. *See also Tax Fairness: Policy and Enforcement: Hearing Before the Subcomm. on Fin. Servs. & Gen. Gov't of the H. Comm. on Appropriations*, 110th Cong. 2 (2007) (written statement of Nina E. Olson, National Taxpayer Advocate), available at [http://www.irs.gov/pub/irs-utl/nta\\_testimony\\_houseapprops\\_030507\\_v7.pdf](http://www.irs.gov/pub/irs-utl/nta_testimony_houseapprops_030507_v7.pdf); 153 CONG. REC. D260 (daily ed. Mar. 5, 2007).

353. *See* IRS OVERSIGHT BOARD, *supra* note 335, at 19; Redston, *supra* note 345, at 580.

354. *See* Alm & Torgler, *supra* note 36, at 239.

355. HM TREASURY, BUDGET 2010, at 18 (2010), available at [http://www.direct.gov.uk/en/NI1/Newsroom/Budget/Budget2010/DG\\_188496](http://www.direct.gov.uk/en/NI1/Newsroom/Budget/Budget2010/DG_188496).

356. OFFICE FOR NAT'L STAT., *supra* note 29, at 365.

357. *See* LORD GRABINER QC, HM TREASURY, THE INFORMAL ECONOMY ii, 1–5 (2000), available at <http://www.hm-treasury.gov.uk/docs/2000/grabiner.html>.

358. OFFICE OF TAX POLICY, U.S. DEP'T OF THE TREASURY, A COMPREHENSIVE STRATEGY FOR REDUCING THE TAX GAP 5 (2006); IRS OVERSIGHT BOARD, *supra* note 335, at 17.

Roosevelt reported that one family had established 197 trusts to divide family income and have it taxed at lower rates and that gifts were used to reduce a \$100 million estate to \$8 million two years prior to one man's death.<sup>359</sup> Similarly, Roosevelt's Secretary of the Treasury, Henry Morgenthau, Jr., complained that one resident of Baltimore, Maryland, established sixty-four trusts for his wife and three children and thereby saved over \$485,000 in federal income taxes in one year.<sup>360</sup>

On the other hand, individual taxation might decrease some costs of administering the American income tax. If Congress uses the adoption of individual taxation as an opportunity to eliminate the innocent spouse rules that mitigate joint and several liability for those filing joint tax returns, it would save a significant amount of government revenue.<sup>361</sup> After Congress liberalized innocent spouse relief in 1998, the Commissioner estimated that 27,000 claims for relief were made the first year.<sup>362</sup> In other years there have been as many as 57,000 claims.<sup>363</sup> These claims must be reviewed and are often litigated.<sup>364</sup> Innocent spouse relief was listed as one of the ten most litigated tax issues for 2010.<sup>365</sup> These provisions thus command a considerable amount of government resources, even though taxpayers prevail even in part

359. *Press Conference Number 225 July 31, 1935*, in 6 COMPLETE PRESIDENTIAL PRESS CONFERENCES OF FRANKLIN D. ROOSEVELT 64, 67, 69 (Da Capo Press 1972) (1935).

360. JOHN MORTON BLUM, FROM THE MORGENTHAU DIARIES: YEARS OF CRISIS, 1928–1938 330 (2d prtg. 1959).

361. See NAT'L TAXPAYER ADVOCATE, 1 2009 ANNUAL REPORT TO CONGRESS 497–506 (2009), available at [http://www.irs.gov/pub/irs-utl/mostlitigatedissues\\_2010arc.pdf](http://www.irs.gov/pub/irs-utl/mostlitigatedissues_2010arc.pdf). Scholars who criticize joint and several liability tend to do so for reasons other than its cost. See generally Am. Bar Ass'n Section of Taxation Domestic Relations Comm., Report, *Comments on Liability of Divorced Spouses for Tax Deficiencies on Previously Filed Joint Returns*, 50 TAX LAW. 395 (1997) (proposing eliminating the innocent spouse defense and attributing liability to the spouse to whom the income in question was attributable); Richard C.E. Beck, *The Innocent Spouse Problem: Joint and Several Liability for Income Taxes Should Be Repealed*, 43 VAND. L. REV. 317 (1990) (arguing joint and several liability is unjust and should be repealed); Amy C. Christian, *Joint and Several Liability and the Joint Return: Its Implication for Women*, 66 U. CIN. L. REV. 535 (1998) (arguing joint and several liability is facially inequitable); Lily Kahng, *Innocent Spouses: A Critique of the New Tax Laws Governing Joint and Several Tax Liability*, 49 VILL. L. REV. 261 (2004) (presenting a structure for implementing innocent spouse rules); Kari Smoker, Comment, *Internal Revenue Service Restructuring and Reform Act of 1998: Expanded Relief for Innocent Spouses—At What Cost? A Feminist Perspective*, 60 OHIO ST. L.J. 2045 (1999) (arguing the innocent spouse rules reinforce social stereotypes of women as victims).

362. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3201, 112 Stat. 685, 734 (1998) (codified at 26 U.S.C. § 6015); Amy Hamilton, *Lawmakers Track IRS Reform One Year Later*, 84 TAX NOTES 517, 519 (1999).

363. U.S. GEN. ACCOUNTING OFFICE, GAO-02-558, TAX ADMINISTRATION: IRS'S INNOCENT SPOUSE PROGRAM PERFORMANCE IMPROVED; BALANCED PERFORMANCE MEASURES NEEDED 15 tbl.4 (2002), available at <http://gao.gov/products/GAO-02-558>.

364. See *id.* at 14–15.

365. NAT'L TAXPAYER ADVOCATE, 2010 ANNUAL REPORT TO CONGRESS 414 (2010).

only 38.9% of the time.<sup>366</sup> These costs might be reduced, if not eliminated, with the switch to individual taxation.<sup>367</sup>

This existence in the U.S. of potentially-offsetting financial benefits from individual taxation complicates the assessment of its impact on government revenue. To the extent the change in tax unit decreases British or American government revenue, it has far-reaching and troubling consequences, many of which were not, and are not, considered during debates over the conversion to individual taxation. As shown by this section, these unintended consequences are complex. It is difficult to determine the full costs of these consequences in the U.K., and even harder to anticipate all of the ramifications in the U.S. of a change in law. This Article is an attempt to begin identifying potential consequences in the U.S. because, despite the analytical difficulty, we must do so if we want to evaluate this proposal intelligently.

### CONCLUSION

The U.K. has often provided examples to the U.S. of progressive policy development.<sup>368</sup> From Britain's earlier women's movement to individual taxation, the U.S. can look across the Atlantic for a guide to changing many different types of laws. Sometimes, however, the guidance is also a warning. The British experience with individual taxation, for example, provides a cautionary tale for the U.S. There are significant complications and unfulfilled hopes that arise from the individual regime that need to be considered before changing the American tax unit. This is true even if adopting individual taxation proves to be the best choice. Individual taxation might afford a more complete sense of equality between the sexes, including reducing indirect sources of inequality, but it also provides a source of tax reduction for an already-benefited group.<sup>369</sup> Only when these negative results are considered in conjunction with the expected benefits of the changed tax unit can governments accurately assess the value of altering the tax regime.

The decision to adopt individual taxation is, therefore, more than a simple decision of whether or not marriage deserves recognition in the tax system.

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366. *See id.* at 417 tbl.3.0.2.

367. The author is working on a paper questioning the justness of eliminating joint and several liability. If we worry that the current system that for better or worse recognizes that wives are often in marital positions of weakness and dependence does not properly recognize the plight of wives, we should not expect a system in which the underlying theory is that wives are independent and not liable for anything but their own income to be more sympathetic.

368. *See, e.g.,* SELIGMAN, *supra* note 13, at 78–79 (noting the adoption of a child tax credit system in 1799); Mehrotra, *supra* note 13, at 213 (discussing the implementation of the British excess profits tax in the early twentieth century).

369. *See supra* notes 2, 4, 21, 187–91, 230 and accompanying text. Indirect inequality is discussed, for example, in Catherine Barnard & Bob Hepple, *Substantive Equality*, 59 CAMBRIDGE L.J. 562 (2000).

Instead, it requires deciding how to allocate a tax reduction among various family types. Unfortunately, when deciding the best tax unit, there is no choice that simply removes distortions in behavior. Each choice always benefits some family arrangement.<sup>370</sup> When the U.K. changed its tax unit, it expected to help one-earner families and encourage that family structure, and the new regime has provided many of its economic rewards to those families. If the U.S. has other goals—for example to provide economic rewards to two-earner couples or to eliminate rewards based on marital status—it needs to draw lessons from the U.K.’s results. The American government should not expect different results from similar actions. If results similar to the British goals are the real intent, American voters should be forewarned.

These repercussions of individual taxation do not seem to be getting sufficient examination or reevaluation in either country. One reason might be the relatively weak position of wives in each society.<sup>371</sup> Women today, as in the past, are seeking economic independence, and poverty remains a women’s issue.<sup>372</sup> In 2009, American women were 35% more likely to be poor and 37% more likely to live in deep poverty than men.<sup>373</sup> In the U.K, the Women’s Budget Group has identified British women as being disproportionately poor; in 2007–2008, women comprised almost 44% of taxpayers, but only 22% of taxpayers with total income over £30,000.<sup>374</sup> Their representation declines at higher income levels.<sup>375</sup> Thus, women’s economic independence in Britain does not seem to be increasing, and those seeking to help them might be willing to try almost any measure to change this.

Although, as shown in this article, individual taxation is not a panacea to wives’ inequality, those who currently oppose the regime in the U.K. are doing so for reasons other than its unintended consequences. Most objections to

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370. The federal income tax system has historically had competing objectives: treating all taxpayers in the same economic position the same way regardless of their marital status (i.e., horizontal equity which may in itself be difficult to define, let alone achieve) and taxing everyone according to their ability to pay (i.e., progressive taxation). The system cannot accomplish these goals at the same time. Bittker, *supra* note 2, at 1396–97.

371. For example, in the U.K., the extent of, or lack of, women’s political power remains a cause of concern. See generally Joni Lovenduski, *Women and Politics: Minority Representation or Critical Mass?*, 54 PARLIAMENTARY AFFAIRS 743, 744 (2001).

372. Lister, *supra* note 174, at 180–91.

373. Press Release, U.S. Census Bureau, Income, Poverty, and Health Insurance Coverage in the United States (Sept. 10, 2009), available at [http://www.census.gov/newsroom/releases/archives/income\\_wealth/cb09-141.html](http://www.census.gov/newsroom/releases/archives/income_wealth/cb09-141.html).

374. HM REVENUE & CUSTOMS, INCOME TAX BY GENDER, REGION AND COUNTRY 2007–2008 1 (2010), available at [http://www.hmrc.gov.uk/stats/income\\_distribution/menu-by-year.htm](http://www.hmrc.gov.uk/stats/income_distribution/menu-by-year.htm) #311. Unfortunately, these statistics do not reflect the marital status of the individuals. For a thorough review of the economic status of British women, see WOMEN’S BUDGET GRP., WOMEN’S & CHILDREN’S POVERTY: MAKING THE LINKS (2005).

375. *Id.*

individual taxation have been made by those advocating on other issues. For example, some advocates of tax reduction advocate joint taxation as a means to lower tax rates.<sup>376</sup> Similarly, the Chancellor has discussed replacing the family credit with an in-work low income tax credit to encourage paid employment, and it would likely mean a return to joint taxation after integrating the welfare and tax systems.<sup>377</sup> These other concerns, though not unworthy of consideration, may someday bring the end of individual taxation without provoking vigorous debate over its value. Much as individual taxation should only be adopted after considering the system's adverse effects, the experiment should only be jettisoned after recognizing that its benefits will also be lost.

Thus, deep thought needs to be given in both countries to the pros and cons of individual taxation, sooner rather than later. The benefits and disadvantages of individual taxation might be clearer after a regime change has been made, but it is hard to overcome the inertia created once the new regime is in place. Evaluating other nations' results might allow the U.S. more complete consideration without entrenching the policy itself. As shown throughout this article, American policymakers should be considering a significant number of intended and unintended consequences likely to result from adopting individual taxation, not in the least because it will be hard to eliminate consequences that benefit a group of taxpayers once a new policy is enacted.

If the U.S. wants to aid two-earner families, as most scholars claim to, the government might consider adopting individual taxation of earned but not unearned income, as operated in the U.K. before the 1988 legislative change.<sup>378</sup> This regime would be far from perfect and would impose administrative costs on taxpayers, create opportunities for abuse (although certainly not as many opportunities as with a completely individual-based system), and, as argued in the U.K., discriminate against wives who generate unearned income. Nevertheless, this bifurcated system would more narrowly target American scholars' complaints than would a complete individual-based regime.

While this Article has drawn many conclusions that policymakers should consider before adopting individual taxation, it leaves unanswered one significant question. That is, why, as the U.K. continues its two decade-long experiment with the individual tax unit, the American government and its scholars have not examined the British experience when they debate changing the American tax unit. Not only does it bode poorly for our consideration of this particular policy, but it also bodes ill for what we might be missing on

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376. Carole Pateman, *Beyond the Sexual Contract*, in *REWRITING THE SEXUAL CONTRACT*, *supra* note 118, at 1, 8.

377. Lister, *supra* note 174, at 188–89.

378. The author thinks there are other problems with taking this approach. See McMahon, *supra* note 110. Re-adopting a two-earner deduction might better target this group.

other issues by not looking at other nations as models. We should be willing to learn from other nations' successes and their mistakes.