ALLOCATION OF TAXABLE INCOME AND NET WEALTH BETWEEN SPOUSES

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1. FEW topics in the field of taxation have attracted more attention than the treatment of married persons respecting income and net-wealth tax. However, some aspects of this popular topic have not been fully covered. The purpose of this article is to discuss one of these aspects.

The income taxation of married persons is most commonly set up as joint taxation, the income tax of the spouses being computed by applying the appropriate tax table to the combined income of the spouses. It is, however, sometimes important to determine the actual share of each spouse in the combined income. This is not true—at least with regard to the relationship between the Government and the taxpayer spouses—in the optional joint taxation of spouses currently in force in the United States, where both spouses are jointly liable for the whole of the tax on their combined income.[1] In Germany, a mandatory system of joint taxation and joint liability was in force until quite recent years,[2] and the Danish taxation is still based on similar principles.[3]

Even in systems of joint taxation and joint liability, however, it may be necessary to determine the income shares of both spouses in order to fix their rights and liabilities against each other. The German income tax acts of 1920 and 1925 contained an express provision to this effect. In the internal relationship between the spouses, the tax on their combined income was to be allocated between them in proportion to the taxes each of them would have had to pay if they had been taxed on their income shares as single persons. If one of the spouses paid to the Government more than his share of the joint tax he was subrogated to the Government's claim against the other spouse.[4]

In many systems of joint taxation, the determination of the in-

[1] See the Internal Revenue Code, 1954, secs. 2 and 6013.

[2] See the German Tax Adaptation Act (Steueranpassungsgesetz), 1934, sec. 7, before the amendment of 1958.

[3] See the Act on National Tax on Income and Net Wealth, 1922, sec. 38, subsec. 2; the Act on Personal Tax to the Municipality, 1959, secs. 40 and 42.

[4] See the Income Tax Act, 1920, sec. 16, subsec. 2; the Income Tax Act, 1925, sec. 22, subsec. 3.

come share of each spouse enters also into the relationship between the Government and the taxpayer spouses. In the present West German optional system of joint taxation this feature is met with in a very modest form. The tax on the combined income is still assessed jointly on both spouses, without taking any account of their respective shares of the income. But if the joint tax is not paid voluntarily and has to be extracted by distraint, the spouse against whom the distraint proceedings have been initiated is entitled to claim that only his share of the unpaid amount be extracted from him. For this purpose, the tax is allocated between the spouses according to those rules of the German income tax acts of 1920 and 1925 that governed the allocation of the tax in the internal relations between the spouses.[5]

There are, however, several systems of joint taxation in which the income shares of both spouses shall or may be taken into account in the ordinary taxation procedure. In Sweden and Finland, for example, the tax on the combined income of the spouses is always assessed separately on each spouse by allocating the total tax in proportion to his share of the combined income.[6] In the United Kingdom and in Norway, a similar separate assessment of tax on each spouse may be elected by either spouse. In Norway, if no election for separate assessment is made in due time, the whole tax is assessed jointly on both spouses. In the United Kingdom, it is assessed on the husband, and, in default of payment by him, is allocated in the same manner as upon election by either spouse, the wife's share of the tax being recoverable from her.[7]

In all the instances mentioned above, the income shares of both spouses influenced only the allocation of their income tax between them and on the liability for the tax so allocated; for the total amount of their income tax it was of no concern. In these cases, allocation of income between spouses is of little interest if both spouses are solvent and on good terms. But there are cases in which the combined income tax of the spouses does depend on their income shares. Earned income of the wife is given a favoured

[5] See the Tax Adaptation Act, 1934, sec. 7, subsecs. 2 and 3, as amended in 1958; Koch, "Die Einschränkung der gesamtschuldnerischen Haftung durch das Steuerreformgesetz 1958", *Deutsche Steuer-Zeitung* 1958, pp. 256 ff.

[6] See the Swedish National Income Tax Act, 1947, sec. 11; the Finnish National Income and Net Wealth Tax Act, 1943, sec. 45; Norr–Duffy–Sterner, *Taxation in Sweden*, Boston–Toronto 1959, pp. 169, 528 ff.

[7] See the British Income Tax Act, 1952, secs. 354–356, 358–360; the Norwegian Rural Tax Act, 1911, sec. 16, subsec. 1; the Norwegian Urban Tax Act, 1911, sec. 11, subsec. 1; the Norwegian Act on the Payment and Extraction of Tax, 1952, sec. 37.

treatment in many countries.[8] In some other countries, such treatment is given to the earned income of the spouse who has earned less.[9] For this purpose, the shares of both spouses in their combined earned income must be determined.

In Finland, the combined income tax of the spouses depends on their income shares in another respect, too. This happens when the net income of one of the spouses is negative, i.e. his deductible expenses and other deductions exceed his gross receipts. In most systems of joint taxation, such "negative net income" is fully deductible from the other spouse's positive net income in determining the income tax base of the spouses.[1] But in Finland, such deduction may not exceed one-third of the net income of the latter spouse.[2] In a case where because of this rule the "negative net income" of one spouse is only partially deductible from the income of the other spouse, their combined income tax is larger than it would have been if they had been able to make the rule limiting the deductibility of the "negative net income" inoperative by distributing their total income in another way.

The system opposite to the joint taxation of spouses, that of separate taxation, is in general use in only a few countries, for example Canada. There, the income shares of husband and wife are always taxed separately. In principle, the income tax is assessed on each spouse on the basis of his income, without regard to the income of the other spouse.[3] Thus, the total income tax of both spouses almost always depends on their respective income shares, and not on their combined income, which has no direct influence on the amount of the tax. In the Finnish local income taxation, spouses are likewise taxed separately. As this tax is proportional, apart from abatements in respect of the very smallest incomes, the total tax of the spouses seldom depends on the allocation of the total income between them.[4]

[8] See, e.g., the Swedish Local Income Tax Act, 1928, sec. 46, subsec. 3; the Danish Act on the Assessment of the National Income and Net Wealth Tax, 1942, sec. 23; the British Income Tax Act, 1952, sec. 210; cf. Norr–Duffy–Sterner, *op. cit.*, pp. 195 f.

[9] See the Finnish National Income and Net Wealth Tax Act, 1943, sec. 28, subsec. 1, point 8; the Norwegian Rural Tax Act, 1911, sec. 16, subsec. 4; the Norwegian Urban Tax Act, 1911, sec. 11, subsec. 4.

[1] See, e.g., the Swedish National Income Tax Act, 1947, sec. 11; Norr–Duffy–Sterner, *op. cit.*, p. 529.

[2] See the National Income and Net Wealth Tax Act, 1943, sec. 42.

[3] See the Canadian Income Tax Act, 1952, secs. 2 and 26.

[4] See the Act on the Municipal Administration in Towns, 1873, sec. 53, subsec. 7; the Act on the Municipal Administration of Rural Communes, 1898, sec. 78, subsec. 7.

Separate taxation is not, however, confined to tax systems where it is in exclusive use. Even in countries where spouses are generally taxed jointly they must be taxed separately in certain cases, for example, for the year of their marriage, or when they are living apart.[5] In the United States and Western Germany, moreover, all spouses are entitled to elect separate taxation, although this right is seldom exercised, since joint taxation is generally more favourable.[6]

Net-wealth taxation is not used so universally as income taxation. In the taxation of the net wealth of married persons we find, however, many similarities to the taxation of their income. To use Finland again as an example, spouses are generally taxed jointly, too; but if their marriage took place during the taxable year, or if they live permanently apart, they are taxed separately, each on his own net wealth. In joint taxation, the tax base consists of the combined net wealth of the spouses. In computing this tax base, the net indebtedness of one spouse (i.e. the excess of his debts and other deductions over his gross assets) is deductible only to the amount of one-third of the net wealth of the other spouse. Finally, the net-wealth tax assessed upon the spouses is allocated between them in proportion to their shares in the combined net wealth, and each spouse is liable only for his share of the tax.[7]

2. An important factor in allocating income and wealth between spouses is the marital property law in force. In the Scandinavian countries, the property relations of spouses, since the Middle Ages, had been regulated according to variations of the community of property system,[8] which has been and still is in extensive use

[5] See, e.g., the Finnish National Income and Net Wealth Tax Act, 1943, sec. 11, subsec. 1; the Swedish Local Income Tax Act, 1928, secs. 52 and 65; the Norwegian Rural Tax Act, 1911, sec. 16, subsecs. 2 and 3; the Norwegian Urban Tax Act, 1911, sec. 11, subsecs. 2 and 3; the Danish Act on National Tax on Income and Net Wealth, sec. 7, subsec. 8; the British Income Tax Act, 1952, sec. 361; Norr–Duffy–Sterner, *op. cit.*, pp. 169 f.

[6] See the American Internal Revenue Code, 1954, sec. 6013; the West German Income Tax Act, 1961, sec. 26, subsec. 1; Blümich and Falk, *Einkommensteuergesetz*, Vol. II, 8th ed. Berlin–Frankfurt 1960, pp. 1357 ff.

[7] See the National Income and Net Wealth Tax Act, 1943, secs. 11, 42 and 45. See also, e.g., the Swedish National Net Wealth Tax Act, 1947, sec. 12; Norr–Duffy–Sterner, *op. cit.*, pp. 640 f.

[8] See, e.g., Andersen, *Ægteskabsret*, Vol. II, Copenhagen 1956, pp. 8 ff., 35 ff.; Arnholm, *Lærebok i familierett*, 3rd ed. Oslo 1958, pp. 177 ff.; Iuul, *Fællig og Hovedlod*, Copenhagen 1940, pp. 172 ff.; Olivecrona, *Précis historique de l'origine et du développement de la communauté des biens entre époux*, Paris 1865, pp. 76 ff. (published also in *Revue historique de droit français et étranger*, Vol. 11, 1865, pp. 354 ff.); Rautiala, *Avioliitto-oikeus*, 2nd ed. Helsinki 1959, pp. 161 ff.

elsewhere.[9] In the 1920's, the Scandinavian marital property law was changed by new uniform legislation.[1] In Finland and Sweden, the new legislation is, however, only applied to spouses whose marriage was celebrated on or after the effective date of the new legislation (in Finland, January 1, 1930).[2] In the "old marriages", property relations are still mainly governed by the old community system.

According to the community of property system applied for centuries in Scandinavia, each spouse could, in addition to the property owned by both spouses in common, own separate property. All the property of the spouses, whether owned in common or owned separately by either spouse, was, however, administered by the husband.[3] During the 19th century, the system was amended by granting the wife the right to administer certain types of community property and of her separate property.[4] In the marital property system still applied in Finland and Sweden to the "old marriages", it is thus possible to distinguish five separate categories with regard to ownership and administration:

(1) separate property of the husband, administered by him;
(2) community property, administered by the husband;
(3) community property, administered by the wife;
(4) separate property of the wife, administered by the husband; and
(5) separate property of the wife, administered by her.

[9] See de Funiak, *Principles of community property*, Vol. I, Chicago 1943, pp. 1 ff., 21 ff. See generally Friedmann, *Matrimonial Property Law*, Toronto 1955; Rouast, *Le régime matrimonial légal dans les législations contemporaines*, Paris 1957; Renard, *Le régime matrimonial de droit commun*, Bruxelles 1960. Cf. Olivecrona, *op. cit.*, pp. 24 ff. (*Revue historique de droit français et étranger*, Vol. 11, 1865, pp. 248 ff.).

[1] See the Swedish Marriage Code, 1920; the Icelandic Act on the Legal Effects of Marriage, 1923; the Danish Act on the Legal Effects of Marriage, 1925; the Norwegian Act on the Property Relations between Spouses, 1927; the Finnish Marriage Act, 1929.

[2] See the Swedish Act for the Promulgation of the New Marriage Code, 1920, sec. 5; the Finnish Act for the Promulgation of the Marriage Act, 1929, secs. 2–4.

[3] See the Swedish (and Finnish) Marriage Code, 1734, Chap. 8, sec. 1, Chap. 9, sec. 1, Chap. 10, secs. 1–7; Andersen, *op. cit.*, Vol. II, pp. 10 ff.; Arnholm, *op. cit.*, pp. 177 f.; Olivecrona, *Om makars giftorätt i bo*, 5th ed. Uppsala 1882, pp. 4 f., 248 ff., 417 ff., 443 ff.

[4] See, *inter alia*, the Swedish Amendments of 1874 and 1898 to the Marriage Code, 1734; the Danish Act to Grant Married Women the Administration of What They Earn Independently, 1880; the Danish Act on the Property Relations between Spouses, 1899; the Norwegian Act on the Property Relationship between Spouses, 1888; the Finnish Act on the Property and Debt Relations of Spouses, 1889.

Similar categories seem to be distinguishable in community of property systems of other countries.[5] I have not found out whether the sixth category needed to make the scheme complete, separate property owned by the husband but administered by the wife, exists anywhere. However, there are community of property systems in which the community property is not only owned but also administered by both spouses in common.[6]

As to the contents of the different categories, employment income usually becomes community property, administered by the spouse who earned it. Property owned by a spouse before the marriage or acquired during the marriage by gift or inheritance often remains his separate property and is administered either by the owner or by the husband. The income produced by separate property usually becomes community property but remains in the administration of the spouse who administers the property producing the income.[7]

No complete uniformity was attained in drafting the uniform Scandinavian marital property legislation. The main principles are, however, the same in all the five countries. During the marriage, each spouse administers the property owned by him before, or acquired by him during the marriage.[8] Liability for debts is generally restricted to the property administered by the spouse who contracted the debt.[9] This is the greatest change brought by the uniform legislation. When the marriage is terminated by death or divorce or the spouses are legally separated, their combined net wealth shall, in the absence of a contrary ante- or post-nuptial agreement, be divided equally between them.[1] This is the most

[5] See Andersen, *op. cit.*, Vol. II, pp. 34 ff.; de Funiak, *op. cit.*, Vol. I, pp. 262, 313 ff.

[6] In the present optional community property system of Western Germany, the community property is administered by the spouses in common, if they have not agreed otherwise. See *Bürgerliches Gesetzbuch*, 1896, sec. 1421, as amended in 1957.

[7] See, e.g., the Finnish Act on the Property and Debt Relations of Spouses, 1889, Chap. 1, secs. 2–4, Chap. 2, secs. 1, 3 and 4; the Finnish Act for the Promulgation of the Marriage Act, 1929, secs. 2 and 3; de Funiak, *op. cit.*, Vol. I, pp. 149 ff., 313 ff.

[8] See the Swedish Marriage Code, 1920, Chap. 6, sec. 2, subsec. 1; the Danish Act on the Legal Effects of Marriage, 1925, sec. 16; the Norwegian Act on the Property Relations between Spouses, 1927, sec. 12, subsec. 1; the Finnish Marriage Act, 1929, secs. 34 and 36.

[9] See the Swedish Marriage Code, 1920, Chap. 7, sec. 1; the Danish Act on the Legal Effects of Marriage, 1925, sec. 25; the Norwegian Act on the Property Relations between Spouses, 1927, sec. 30; the Finnish Marriage Act, 1929, sec. 52.

[1] See the Swedish Marriage Code, 1920, Chap. 6, secs. 1, 2 and 8, Chap. 7, sec. 1; the Danish Act on the Legal Effects of Marriage, 1925, secs. 15, 21 and

important difference between the Scandinavian system and, for example, the present British system. But in spite of these similarities in the main principles, there are many minor differences among the Scandinavian marital property laws. The Swedish and Finnish drafters were prone to underline the independence of the spouses by calling each spouse the "owner" of the property administered by him even where the property in question was subject to equal division between the spouses at the termination of the marriage.[2] In the other countries, and especially in Denmark, the form of the old system was more closely adhered to by the retention of the name "community property" for the property subject to division. With regard to such property, these drafters refrained from using the word "owner" at all.[3] These differences in attitudes had an influence not only on the form but also on the content of certain provisions in the legislation.[4]

3. Allocation of community income and property for taxation is often not regulated in tax legislation. In the United States, the courts have held that income shall be allocated according to ownership. Community income is thus split equally between the spouses.[5]

28; the Norwegian Act on the Property Relations between Spouses, 1927, secs. 11, 12, 22 and 26; the Finnish Marriage Act, 1929, secs. 35 and 100.

[2] See the Finnish Marriage Act, 1929, sec. 34.

[3] See Andersen, *op. cit.*, Vol. II, pp. 43 ff.; Arnholm, *op. cit.*, pp. 215 f.

[4] Thus, in Denmark and Norway, but not in Finland, certain kinds of misbehaviour of one spouse may entitle the other spouse to claim that the "community property" be divided during the marriage. In Denmark and Norway, "community property"—both in case of separation or termination of the marriage and in the cases mentioned in the preceding sentence—is distributed according to principles similar to those applicable to the distribution of a deceased person's estate, whereas in Finland the essential arrangement is that the amount of the net wealth subject to the division and administered ("owned") by each spouse is computed, and the spouse whose net wealth is larger pays half of the difference to the other either in kind or in money. And in Denmark, a post-nuptial agreement turning community property into separate property, or vice versa, is often regarded as a gift by one spouse to the other even if the administration of the property is not changed by the agreement. See the Danish Act on the Legal Effects of Marriage, 1925, secs. 36, 38–42; the Danish Act on the Partition of a Deceased Person's Estate and of Community Estate, 1874, secs. 57–70 b; the Norwegian Act on the Property Relations between Spouses, 1927, secs. 39–44; the Norwegian Act on the Partition of Estates, 1930, secs. 47–52; the Finnish Marriage Act, 1929, secs. 100 and 103; Andersen, *op. cit.*, Vol. II, pp. 59 ff., 91 f., 184 ff.; Arnholm, *op. cit.*, p. 226. With regard to matters here mentioned Swedish law is closer to Danish and Norwegian law than to Finnish. See *Statens offentliga utredningar* 1929: 12, pp. 33 f., 48 ff. See further Malmström, "Sweden", in Friedmann, *op. cit.*, pp. 410 ff.; Munch, "Danemark", Godenhielm, "Finlande", Hiorthöy, "Norvège", and Hessler, "Suède", in Rouast, *op. cit.*, pp. 109 ff., 177 ff., 261 ff., 301 ff.; Renard, *op. cit.*, pp. 198 ff.

[5] See, e.g., *Poe* v. *Seaborn*, 282 U.S. 101; de Funiak, *op. cit.*, Vol. I, pp. 670 ff.; Mertens, *The Law of Federal Income Taxation*, Vol. 3, rev. ed. Chicago 1957, § 19.01.

In Sweden and Finland, other principles have been applied to marriages with community property (i.e. the "old marriages"). According to the earlier practice of the administrative courts, the husband was taxed for the income of both spouses. By special enactments a new system was introduced. Both income and assets were to be allocated between the spouses according to administration.[6] In Finland, this system is still in force, but in Sweden it was repealed in 1928. According to the Swedish enactments of that year, each spouse is taxable for his separate income and wealth, and the husband for the common income and wealth of the spouses.[7] If these provisions were to be construed literally, all, or nearly all income of the spouses in "old marriages", including income earned by the wife as an employee, would be allocated to the husband because it belonged to the community. It seems, however, that such results were not intended by the drafters of the enactments of 1928, nor have the provisions concerned been applied literally. Probably the only result of the legislation is that any separate income and property belonging to the wife but administered by the husband is allocated to the wife.[8]

According to Finnish and Swedish law, property and income of spouses in "new marriages" are also allocated according to administration. Thus, no regard is paid to the rules which in some situations, for example in the transfer of real property,[9] make the consent of the other spouse a condition for the validity of a legal transaction, or provide for an equal division upon separation or dissolution of the marriage. This seems consistent, for even if

[6] See the Swedish National Income Tax Act, 1907, sec. 5, subsec. 1, as amended in 1908; the Swedish Act on Special Tax on Real Property and Income (Bevillningsförordningen), 1907, sec. 7, subsec. 2, as amended in 1908; the Finnish National Income and Net Wealth Tax Act, 1920, sec. 7, subsec. 1 (now replaced by the National Income and Net Wealth Tax Act, 1943, sec. 11, subsec. 1); the Finnish Act on the Municipal Administration in Towns, 1873, sec. 53, subsec. 7, as amended in 1923; the Finnish Act on the Municipal Administration of Rural Communes, 1898, sec. 78, subsec. 7, as amended in 1923. See also Bodin and Palmgren, *Självdeklaration,* 6th ed. Stockholm 1909, pp. 4 f.; *Statens offentliga utredningar* 1949: 47, pp. 19 ff.; Laurila and Ahla, *Kunnallisverolait,* 3rd ed. Helsinki 1930, pp. 75 f.; Ståhlberg, *Lait ja asetukset maalaiskuntain hallinnosta,* 3rd ed. Helsinki 1926, p. 502.

[7] See the Local Income Tax Act, 1928, sec. 52; the National Income and Net Wealth Tax Act, 1928, sec. 19 (now replaced by the National Income Tax Act, 1947, sec. 11, and the National Net Wealth Tax Act, 1947, sec. 12).

[8] See *Statens offentliga utredningar* 1924: 53, pp. 439 f.; Björling, "Till giftermålsbalkens tioårsdag", *Sv.J.T.* 1930, pp. 322, 327.

[9] See the Swedish Marriage Code, 1920, Chap. 6, secs. 3–6 a; the Danish Act on the Legal Effects of Marriage, 1925, secs. 17–20; the Norwegian Act

those rules are taken into account, the position of the spouse administering the property is much nearer to the position of an owner than it was in the "old marriages". As mentioned before, in Sweden and in Finland he is even called the owner.

One of the countries where allocation of income between spouses has not been regulated by legislation is Western Germany. Several systems of marital property relations exist. The spouses are entitled to choose a system by an ante- or a post-nuptial agreement. If no election is made a system indicated in the law applies.[1] According to the indicated system in force until 1953, each spouse had his separate property, but the husband was, with some exceptions, entitled not only to the administration but also to the enjoyment of the wife's property.[2] It was natural that such income was also allocated to the husband for purposes of taxation.[3] The system currently in force in the absence of nuptial agreements is in many aspects similar to the Scandinavian system,[4] and the income tax consequences are the same as there.[5]

The community of property system lies among the choices German married couples may elect by ante- or post-nuptial agreement.[6] The income tax consequences of this system have not yet been definitely settled. The predominant view seems to be that neither ownership nor administration can alone decide the allocation of income. Instead, income should be allocated following "the economic point of view": earned income to the spouse earning the income, but property income equally to both spouses. However, there are advocates of the view that all community income should be allocated according to ownership, which would imply that spouses took equal shares.[7]

on the Property Relations Between Spouses, 1927, secs. 13–17; the Finnish Marriage Act, 1929, secs. 37–40.

[1] See *Bürgerliches Gesetzbuch,* 1896, secs. 1363 and 1408, as amended in 1957. For further discussion, see Reinicke and Schwartzhaupt, *Die Gleichberechtigung von Mann und Frau,* Stuttgart 1957, pp. 14, 48 ff.

[2] See *Bürgerliches Gesetzbuch,* 1896, secs. 1363–1417 in their original version.

[3] See Blümich and Falk, *op. cit.,* Vol. II, p. 1390; Herrmann and Heuer, *Kommentar zur Einkommensteuer einschl. Lohnsteuer und Körperschaftssteuer,* Vol. III, 8th ed. Cologne 1958, p. E 1218[31].

[4] See *Bürgerliches Gesetzbuch,* 1896, secs. 1363–1390, as amended in 1957.

[5] See Blümich and Falk, *op. cit.,* Vol. II, pp. 1390 f.; Herrmann and Heuer, *op. cit.,* Vol. III, pp. E 1218[36] f.

[6] See *Bürgerliches Gesetzbuch,* 1896, secs. 1415–1470, as amended in 1957. See also Reinicke and Schwartzhaupt, *op. cit.,* pp. 51 ff.

[7] See Blümich and Falk, *op. cit.,* Vol. II, pp. 1393 ff.; Herrmann and Heuer, *op. cit.,* Vol. III, pp. E 1218[82] ff.

4. It is often difficult to set apart the income or property shares of both spouses, especially when the labour or property of both spouses is employed together in earning income. Let us suppose that a farm belonging to the wife, or under her administration, is in fact managed by the husband. The profits from the farm are nevertheless allocated to the wife (unless they are considered community income and such income is allocated according to ownership).[8] The wife may (as, on certain conditions, in Western Germany) or may not (as in Sweden and Finland) deduct salary paid to the husband.[9] But the husband may also rent the farm from the wife. In this case, she is to be taxed only on the rent and the husband on the remaining income from the farm.[1] A third possibility is that the farm is used in a joint enterprise of the spouses. In this case, the income shall be divided according to the shares of the spouses in the enterprise. The circumstances in each separate case determine whether the husband shall be regarded as an estate manager, a tenant, or a partner of the wife.

Various benefits are treated in taxation as income although they are received neither in money nor in other tangible or intangible property. Obviously, such benefits can be neither owned nor administered by either spouse. Suppose that the director of a company and his wife make a trip abroad at the expense of the company, ostensibly for business purposes. If the tax authorities are of the opinion that the trip was in reality made for pleasure, they may regard the value of the trip as additional compensation for the director's services. But if his salary is ample and his wife has a substantial shareholder interest in the company, the value of the trip may instead be regarded as a dividend on her shares. There seems to be no reason to allocate the income in a manner other than that in which a corresponding income in money would have been allocated.[2] Thus, if the value of the trip is treated as

[8] See the Finnish Marriage Act, 1929, sec. 36; *O.M.H. and wife* v. *Commune of K.*, 1941 KHO sec. II No. 478.

[9] See the West German Income Tax Act, 1961, sec. 26a, subsec. 1; the Swedish Local Income Tax Act, 1928, sec. 20, subsec. 2; *id.*, sec. 22, subsec. 1; *id.*, Supplementary instruction No. 6 to sec. 22; *id.*, Supplementary instruction No. 11 to sec. 29; the Finnish National Income and Net Wealth Tax Act, 1943, sec. 26, subsec. 1, point 3. See further Blümich and Falk, *op. cit.*, Vol. II, pp. 1377 ff.; Herrmann and Heuer, *op. cit.*, Vol. III, pp. E 1218[39] ff.; Rekola, *Tulo- ja omaisuusverolaki*, Helsinki 1947, pp. 254 f.; Suviranta, *Palkkatyön käsite verooikeudessa*, Helsinki 1961, pp. 27 ff.

[1] See *E.E.J. and wife* v. *Commune of S.*, 1952 KHO sec. II No. 411; Mertens, *op. cit.*, Vol. 2, rev. ed. Chicago 1955, § 17.03.

[2] Compare the American doctrine that "fruits cannot be attributed to a different tree from that on which they grew". See *Lucas* v. *Earl*, 281 U.S. 111 (1930).

additional salary to the husband, it is generally allocated wholly to him; but it is split equally between the spouses if the community system is applied and income is allocated according to ownership. And if the value of the trip is regarded as a dividend on the wife's shares, it is generally allocated wholly to the wife. If, however, the community system applies, the "dividend" is split equally between the spouses if taxation follows ownership, or allocated wholly to the husband if taxation follows administration and income produced by the wife's property is administered by the husband. No attention will be paid to the fact that the trip was enjoyed by both spouses. The same rules will be applied if the trip is made by the husband or the wife alone.

5. In order to determine the income and wealth shares of both spouses, it is not sufficient to allocate their gross receipts and gross assets. The expenses, debts and other deductions from receipts and assets must also be allocated. Very little attention has been given to this question.

Expenses incurred in producing income do not present any great problems. Their allocation follows the rules for allocating the income in the production of which they were incurred.[3] This is the case even if the expenses were not paid out of the assets owned or administered by the spouse who is taxed for the income produced by the expenses. In this case, the amounts paid as expenses are regarded as gifts or advances from one spouse or property sphere to the other spouse or another property sphere.[4]

Generally speaking, income tax is a tax on net income, i.e. the income available for family consumption and saving. Nevertheless, living expenses are sometimes deductible in determining the tax base. Thus, medical expenses and life insurance premiums are wholly or partially deductible in many income tax systems, and interest on debts seems to be deductible everywhere without regard to whether the debts were incurred for business or private purposes.

As prescribed in the uniform Scandinavian legislation, each spouse is obliged to contribute to the maintenance of the family according to his capacity. A spouse who pays more than his proper share in meeting the expenses of the family has a claim against the other spouse for the excess. This right of recovery is, however, kept within narrow limits. The spouses may also conclude agree-

[3] See de Funiak, *op. cit.*, Vol. I, p. 695.
[4] See Rautiala, *op. cit.*, pp. 263 f., 271.

ments with each other with regard to the manner in which each of them shall participate in the maintenance of the family.[5] In other countries, the maintenance duties of the spouses may be determined otherwise than in Scandinavia.[6] Be that as it may, taxation authorities clearly should not question the manner in which the spouses participate in the upkeep of the family. Thus, the deductible living expenses should be allocated to the spouse who owned or, if income is allocated according to administration, administered the means used to pay the expenses.[7]

Finally, there are deductible outlays constituting neither living expenses of the family nor expenses for the production of income —for example, payments of alimony to a former spouse or support to a child born out of wedlock. Such payments can in general be deducted only from the income of the spouse who is liable to pay the sums in question. This rule applies even when community property is used for the payments. Such payments will then operate to diminish the share of the liable spouse in the community. "Each spouse shall suffer for his doings alone and not waste the share of the other."[8] The picture will change, however, when income is allocated according to administration. In the "old marriages", liability for the payments in question is generally not restricted to means administered by the liable spouse.[9] Thus, property owned by the liable spouse or by both spouses in common, but administered by the non-liable spouse, may be used for such payments. In such a case, the latter spouse must be entitled to deduct the payments from his income share. In England, until 1935, the husband was liable for the tortious acts of both spouses.[1] In so far

[5] See the Swedish Marriage Code, 1920, Chap. 5, secs. 2–6, 10; the Danish Act on the Legal Effects of Marriage, 1925, secs. 2–5, 8, 9; the Norwegian Act on the Property Relations between Spouses, 1927, secs. 1–3; the Finnish Marriage Act, 1929, secs. 46–50.

[6] See, e.g., *Halsbury's Laws of England,* Vol. 19, 3rd ed. London 1957, pp. 817 ff.; Rouast, *op. cit.,* p. 21.

[7] Cf. the West German Income Tax Act, 1961, sec. 26 a, subsec. 2; the British Income Tax Act, 1952, sec. 358, subsec. 2.

[8] See the Swedish Marriage Code, 1734, Chap. 11, sec. 4 (the Code of 1734 was the law of the land in Finland, which at that time was a part of the Swedish realm); the Finnish Act on the Property and Debt Relations of Spouses, 1889, Chap. 4, sec. 5; *Bürgerliches Gesetzbuch,* 1896, secs. 1441–1443, 1463–1466, as amended in 1957; de Funiak, *op. cit.,* Vol. I, pp. 435 ff., 448 ff., 462 ff., 467 ff., 516 ff., 529 ff.

[9] See, e.g., the Finnish Act on the Property and Debt Relations of Spouses, 1889, Chap. 4, secs. 4 and 5.

[1] See *Barber* v. *Pigden,* [1937] 1 All E. R. 115; *Halsbury's Laws of England, op. cit.,* pp. 875 f.; de Funiak, *op. cit.,* Vol. I, pp. 518 ff. Cf. the British Law Reform (Married Persons and Tortfeasors) Act, 1935, sec. 3.

as such rules still exist, deductible payments based on such liability must evidently be deductible from the husband's income.

The above discussion on the allocation of deductions is intended to cover deductions granted on the basis of actual outlays. There are other deductions, often called "allowances", that are not based on actual expenditure but are granted as fixed sums or percentages, for example, child allowances and earned-income allowances. Such deductions are allocated according to rules that seem to have little in common with the principles for the allocation of other income items (gross receipts and actual outlays). Thus, those rules fall outside the scope of this article.

6. A debt incurred for business purposes is normally contracted by the spouse who runs the business. In such a case, the debt will obviously be allocated to this spouse.

It is, however, common that a person or institution granting credit to a married person requires that both spouses sign the debt instrument, thus making the spouses jointly responsible for the debt. For one reason or another, the debt may also be in the name of the spouse not running the business in question. Further, according to marital property laws in various countries, both spouses are occasionally liable for debts contracted by one spouse alone. In all three situations, the "businessman-spouse" is responsible for the whole debt with regard to the internal relations of the spouses. If the other spouse pays the debt, he becomes subrogated to the rights of the creditor against the "businessman-spouse". Therefore, for taxation purposes the debt is to be allocated to the "businessman-spouse" without regard to the question whether in relation to the creditor the other spouse is responsible for its payment.

A debt incurred for the business purposes of one spouse is not, however, totally without significance in the net wealth taxation of the other spouse, if the latter is jointly and severally, or solely liable for the debt to the creditor. A parallel can be drawn between the liability of the latter spouse and that of a surety. Such liability cannot normally be deducted in computing the surety's net wealth. But if the principal debtor becomes insolvent, the surety will be allowed to deduct his liability: it is no longer offset by his now valueless subrogation right.[2] Similarly, if the "businessman-spouse" has become insolvent, and cannot be expected to be able to pay the debt when it becomes due, the "surety

[2] See the Swedish National Net Wealth Tax Act, 1947, sec. 5, subsec. 4; *N. v. State Attorney*, 1943 KHO sec. II No. 296; Rekola, *op. cit.*, p. 335.

spouse" should be entitled to deduct the amount of his liability against the creditor, diminished by the value, if any, of his subrogation right against the "businessman-spouse". But, of course, the same debt cannot be deducted by both spouses.

What has been said above must be modified somewhat with regard to community of property systems. If the business property is owned by the spouses in common and taxation follows ownership, the business debt is to be split between the spouses; each spouse may then have the position of a surety with regard to the debt share allocated primarily to the other spouse.

As mentioned before, living expenses are allocated according to their actual payment with the means owned or administered by one spouse or the other. In principle, the same rule applies to the allocation of consumption debts.[3] However, at the end of the taxable year it is often impossible to know how the payment of unpaid debts will be divided between the apouses. Thus, such debts must be allocated as requested by the spouses. The manner in which the spouses divide their liability as to the creditor is generally irrelevant. However, if only one spouse is liable to the creditor, and this spouse is insolvent, the debt cannot be allocated to the other spouse.

There remain the "private debts" of a spouse, i.e. antenuptial debts, and debts other than those incurred for business purposes or for the maintenance of the family. As stated before with respect to the allocation of alimony payments and similar deductions, usually only the debtor spouse is responsible for such debts. This is so in community systems, too. Thus, private debts are generally allocated to the debtor spouse only. However, if taxation follows administration and some or all property owned by the debtor spouse (separately or in common with the other spouse) is administered by the other spouse, the debt may be deducted alternatively or exclusively in the taxation of the latter spouse.

[3] It can be maintained that it is often impossible to distinguish the business debts of a person from his consumption debts. Borrowed money may be intermingled with the debtor's own money, thus making it impossible to know which is used for the various outlays. And even if the origin of the money could be traced, it clearly would often be a very haphazard ground for classifying debts. But although absolute certainty cannot always be reached in the classification of debts, a reasonable estimation can be made according to the circumstances of each case. Cf. Ikkala, *Luonnolliset vähennykset ja liiketulo,* Helsinki 1962, pp. 240 ff.; Andersson, *Resultatutjämning vid inkomstbeskattningen,* Helsinki 1962, pp. 251 ff.