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The Marriage Tax Penalty: An Overview of the Issues

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ABSTRACT

Proposals to reduce marriage tax penalties have received attention; the House has adopted H.R. 6 and the Senate Finance Committee has reported S.2346 (with provisions ultimately included in the reconciliation bill, S. 2839), both bills that address this issue. The Administration has also proposed tax changes to address the marriage penalty. This report explains the causes and size of the marriage penalty, examines alternative proposals, and discusses how they affect horizontal equity, efficiency, and complexity. This report will be updated as legislative developments occur.

The Marriage Tax Penalty: An Overview of the Issues

Summary

Both Democrats and Republicans have expressed interest in reducing the marriage tax penalty. The House adopted a marriage tax penalty reduction bill (H.R. 6) on February 10. The Senate Finance Committee also reported a marriage penalty bill, S. 2346, whose provisions were included in a reconciliation proposal in June (S. 2839). The Administration has also proposed tax changes to address the marriage penalty.

A marriage penalty arises for some families because family income is combined and subject to progressive tax rates. Other couples, however, experience bonuses because the exemption amounts and rate brackets are larger for the joint returns filed by married couples than for singles' returns. Approaches to addressing the marriage penalty include expanding standard deductions and rate brackets for joint returns, optional separate filing, and second-earner deductions. Marriage penalties at lower income levels also arise because of the earned income tax credit (EITC).

It is not possible to measure the marriage penalty or bonus precisely because the taxes a married couple would pay as two singles depends on the division of unearned income, itemized deductions, and the custody of children. When children are allocated based on typical observed behavior, the Congressional Budget Office has estimated that 37% of married couples have penalties ($24 billion), 3% are unaffected, and 60% have bonuses ($73 billion). Even if children are assigned in a way to minimize taxes, 43% of joint returns had penalties of $32 billion and 52% had bonuses of $43 billion.

This analysis suggests that any proposal to reduce taxes for married couples would increase horizontal inequities that generally tend to penalize singles, based on an ability-to-pay standard and using the relative poverty scales to measure relative ability-to-pay. (At high income levels, larger families with children pay the heaviest taxes, but at low and middle income levels, the highest taxes are paid by single individuals and the lowest are paid by families with children).

Our analysis also suggests that optional filing may be an efficient approach to eliminating marriage penalties at the smallest revenue cost, but would add to tax complexity. Expanding standard deductions and rate brackets for joint returns would be simple, but would cost the most and would expand marriage bonuses. Second-earner deductions add some minor complexity but, while not as target-efficient as optional filing would be more targeted than general tax reductions for joint returns. Per dollar of revenue loss, second earner deductions are most likely to reduce behavioral distortions with respect to labor supply of married women, while joint return reductions are least likely to reduce these benefits. This report will be updated as legislative developments occur.

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The marriage tax penalty (the increase in taxes that can arise when two single taxpayers marry) is the subject of several legislative proposals. Provisions addressing the marriage penalty were included in H.R. 2488, the general tax cut which was passed in 1999 but vetoed by the President. The House Ways and Means Committee reported a marriage tax penalty reduction bill (H.R. 6) on February 2 which included marriage penalty provisions in H.R. 2488; the House passed the bill on February 10. These provisions would cost $50.7 billion over the next five years and $182.3 billion over the next ten years. The Senate Finance Committee has reported a $287 billion five year marriage penalty tax cut (S. 2346), whose provisions were included in a reconciliation proposal in June (S. 2839). Because of budget rules, these provisions will sunset in five years and cost $55 billion. The Administration has also proposed more limited marriage penalty relief and has proposed revision of the Earned Income Tax Credit (EITC) including provisions addressing marriage penalties. Numerous other bills have been introduced in the Congress on this subject.[1]

This report is an overview of basic issues associated with the marriage penalty.[2] The first section explains how the marriage penalty (and the marriage bonus) arises and why it is not possible to achieve simultaneously the goals of marriage neutrality and horizontal equity across families in a progressive tax system. The second section discusses the size of the marriage penalty and bonus and, importantly, the notion that the marriage penalty is not a precisely defined measure. The next section outlines the basic issues of equity, efficiency and simplicity that are part of the framework for evaluating policy and the final section discusses various legislative proposals in light of these objectives.

How Marriage Penalties and Bonuses Arise

The U.S. system imposes taxes on a family basis, and thus combines the income of married couples, who file joint returns. The tax system is also progressive, allowing standard deductions and personal exemptions, and providing higher tax rates as income rises (currently at 15, 28, 31, 36, and 39.6 percent). These two features

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[1] See the Congressional Research Service's Electronic Briefing Book on taxation at [http://www.congress.gov/brbk/html/ebtxr1.html], particularly the entries on congressional and administration proposals, the marriage penalty, and bills for discussions. See also CRS Report 98-679, *Marriage Tax Penalties: Legislative Proposals in the 106th Congress* by Gregg A. Esenwein, for further discussion.

[2] A more detailed report on this subject is CRS Report 98-653, *The Marriage Penalty and Other Family Tax Issues*, by Jane G. Gravelle.

of the tax system mean that the tax system cannot be marriage neutral. For example, in 1999, the standard deduction for a single return was $4,300, while the standard deduction for a joint return was $7,200. The first taxable income bracket applies to taxable income up to $25,750 for a single return and $43,050 for a joint return. If two single individuals with $30,000 of income married, their tax liability would rise from $6,885 to $7,648, or by $763. While their combined standard deduction before marriage was $8,600, their standard deduction now would become $7,200. Moreover, combining their incomes would result in some part of their income being taxed at the higher rate of 28 percent. If, however, a single individual earning $60,000 married another individual with no income, his or her tax liability would fall from $9,230 to $7,648, or by $1,582. By marrying, the single individual is now eligible for a larger standard deduction, an additional personal exemption of $2,750 for the new spouse, and a wider 15 percent rate bracket.

In our current tax system, some married couples pay higher taxes than they would if they were single (marriage penalties) and some pay lower taxes (marriage bonuses). Bonuses are greatest when incomes of the two spouses are less equal, while penalties become greatest when incomes of the two spouses are more equal.

These fundamental sources of the marriage penalty can also be used to understand the three basic types of legislative changes proposed (all of which have been introduced in the 106th Congress). (1) Some proposals would **reduce the taxes for joint returns** by increasing the standard deduction (and in some cases the bracket widths) to twice those of single returns. If all bracket widths were increased, all marriage penalties would be eliminated, but bonuses would be increased (ignoring the earned income tax credit and other issues discussed below). If only the standard deduction were increased, the marriage penalty would be eliminated only for taxpayers whose income fell in the 15 percent bracket. This approach was used in the House passed version of last year's tax cut bill, H.R. 2488. The conference report on that bill increased the standard deduction and the first rate bracket, which would eliminate the marriage penalty for many taxpayers; H.R. 6 follows this pattern. S. 2346, follows the approach in the House bill and also expands the 28 percent bracket to twice that of single returns. (2) Another alternative would be to allow **optional single filing**, so that individuals could choose to file as singles. This approach was used in the Senate version of H.R. 2488. In that case, all penalties would be eliminated, but bonuses would not be increased. (3) A final option would be to allow a **second-earner deduction** (a deduction of part of the earnings of the lesser earning spouse) which reduces penalties and increases bonuses but does not affect one-earner couples. Such an approach has been used in prior tax law to address marriage penalty issues. A related option, contained in the President Clinton's proposals, is to increase the standard deduction more for two-earner couples.[3]

There are some other complications of the system that affect the size of marriage penalties or bonuses. If one or both of the individuals in the examples above had children, then the penalties and bonuses would be different. Single parents are eligible

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[3] Marriage tax penalty proposals are also contained in tax plans of some presidential candidates. See CRS Report RS20424, Tax Proposals of the Presidential Candidates, by Jane G. Gravelle.

for head-of-household status. Heads-of-households have a standard deduction of $6,450, larger than that for singles but smaller than that for joint returns. In addition, the width of the tax brackets ($35,150 for the 15 percent bracket) is wider than that for singles and smaller than that for joint returns. As a result, the marriage penalty would be larger for two individuals with similar incomes. However, children can also make the marriage bonus larger in some cases: if an individual marries someone who earns no income or insufficient income to use up personal exemptions and child credits, the marriage bonus would increase.

A second complication of the tax system is the earned income tax credit, which affects the tax liabilities of low income individuals. The earned income tax credit can add to marriage penalties, because the credit is phased out as income rises, and marriage of two individuals with earnings can cause a quicker phase out. The earned income tax credit can also result in a bonus, if a single individual marries another individual with children but without earnings, or with very small earnings, because the earned income credit is larger for families with children. President Clinton and Chairman Archer have proposed to lessen the marriage penalty contained in the earned income tax credit.

Table 1 provides some calculations of the effective tax rate across different income levels for different family circumstances, for married couples and singles with the same combined income. The first set of calculations shows the average effective tax rates for individuals without children. At the lowest level, a $10,000 income, there is a significant benefit to remaining single, with an even split, primarily because these individuals do not get phased out of the EITC. That is, two single individuals, each with the same low income are each eligible for the EITC, but if they marry, their combined income may be too high and the EITC will be phased out in part or entirely. When only one person earns the income, the phaseout of the EITC is not affected, but the single taxpayer is penalized by the lower standard deduction of singles; as a result there is a marriage bonus (tax liability would fall with marriage because the standard deduction would increase and an additional personal exemption allowed). Through most of the middle incomes, there is virtually no marriage penalty as a percentage of income, but significant marriage bonuses.

The second set of calculations shows the effects of marriage between singles, where one has a child. The individual with the child is assumed to be the non-earner in the case of the 100/0 split; if the earner was assumed to have the child, the bonus would be smaller because the single earner would be taxed at lower head-of-household rates. The assumption that children remain with the non-earner reflects the likelihood that children would remain with the non-working spouse, who is typically the mother, in the event of divorce, or would have had custody of the children if the couple were never married. According to the Census Bureau, 85% of children who live with one parent live with their mother.[4]

Note that none of this discussion considers the effect of the alternative minimum tax (AMT) which contains its own marriage penalty at some levels. Provisions

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[4] U.S. Census Bureau, Current Population Reports, Marital Status and Living Arrangements, March 1997.

directed at the regular tax marriage penalty will not affect couples subject to the AMT, and some couples may not receive full tax benefits because they will shift to the AMT or have their credits reduced by the AMT. The Senate Finance Committee proposal, however, reduces the interaction beyond what it would otherwise be by permanently allowing credits against the AMT.[5]

Table 1: Average Effective Income Tax Rates for Joint Returns and Unmarried Couples, By Size of Income and Degree of Split

	Income Level for a Family of Two						
Type	$10000	$20000	$35000	$50000	$75000	$100000	$200000
No Child							
Joint	0.00	0.06	0.10	0.10	0.13	0.16	0.20
Single 50/50 Split	-0.07	0.05	0.09	0.10	0.12	0.14	0.19
Single 100/0 Split	0.05	0.10	0.13	0.15	0.17	0.19	0.23
One Child							
Joint	-0.18	0.02	0.08	0.09	0.13	0.16	0.22
Single 50/50 Split	-0.19	0.02	0.06	0.06	0.12	0.14	0.19
Single 100/0 Split*	0.07	0.10	0.13	0.15	0.17	0.19	0.23

*Individual without the child is assumed to be the earner. If the individual with the child is the earner, the row would read -0.18, 0.03, 0.09, 0.12, 0.16, 0.18, 0.23.
Source: Congressional Research Service Report 98-563, *The Marriage Penalty and Other Family Tax Issues*. Income levels are for 1997, but the effective tax rates would be virtually the same at 2000 income levels because the tax system is indexed. Note that effective tax rate does not always rise across incomes due to rounding.

The Marriage Penalty or Bonus Cannot Be Precisely Measured

Although people refer to the marriage penalty for a particular family situation or the aggregate size of the marriage penalty, it is really not possible, in many cases, to determine the size of the penalty or bonus. Only when a married couple has only

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[5] See CRS Report RL30485, The Individual Alternative Minimum Tax: Interaction with Marriage Penalty Relief and Other Tax Cuts, by Jane G. Gravelle, for further discussion.

earned income, no dependent children, and no itemized deductions or other special characteristics, and only if it is assumed that their behavior would not have been different if their marital status had been different, can one actually measure the size of the marriage penalty or bonus. There is no way to know who would have custody of the children and therefore which of the partners might be eligible for head of household status and for the accompanying personal exemptions and child credits.

The Congressional Budget Office has estimated, using an allocation that reflects typical behavior of married couples with respect to child custody, that 37% of married couples have penalties ($24 billion), 3% are unaffected, and 60% have bonuses ($73 billion). (Itemized deductions and earned income were assigned in proportion to earnings). The net bonus is $49 billion.[6] However, in most of its analysis, the CBO study relied on a measure of marriage penalties and bonuses that assumed child custody would be based on a tax-minimizing strategy. For example, if parents of two children had similar individual earnings, each would be assumed to have custody of one of the children so that both would be eligible for head-of-household status. Even using that standard, net bonuses occur: 43% of married couples had penalties amounting to $32 billion, and 52% had bonuses of $43 billion, for a net bonuses of $11 billion. Nevertheless, as here noted, a significant proportion of married taxpayers–between 37% and 43%–pay marriage penalties.

A study using Treasury data and other assumptions produced different measures of the marriage bonus or penalty.[7] Using an assumption that divorced parents occupied the same residence, and thus only one could qualify for head of household status, the authors found that 48% had a penalty ($28.3 billion) and 41% had a bonus ($26.7 billion), for a net penalty of $1.6 billion. This study also provided several other ways of measuring penalties and bonuses, including estimating $30.2 billion in singles penalties because these individuals could not use joint return rate schedules. Interestingly, most of the Congressional proposals do not propose to allow married couples the benefits of head-of-household status, which applies to a relatively small group of individuals. Without head-of-household status, the Treasury found that 46% of couples have bonuses ($36.6 billion), 43% have penalties ($20.8 billion) and the net effect is a bonus of $15.8 billion.

An alternative measurement is the bonuses and penalties of single individuals who are cohabitating, a much smaller group of people. In 1997, according to the Census Bureau, there were 109.2 million married adults living with their spouses (55 million households), but only 4.1 million unmarried couple households. Thus, assuming that these households were similar to married households, the "single

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[6] These and other numbers discussed in this paragraph are from an update of a study by the U.S.. Congressional Budget Office, *For Better or for Worse: Marriage and the Federal Income Tax*. Washington , DC, June 1997. These numbers were updated for 1999 in a memorandum from Bob Williams and David Weiner of CBO dated September 18, 1998.

[7] Nicholas Bull, Janet Holtzblatt, James R. Nunns, and Robert Rebelein. Assessing Marriage Penalties and Bonuses. *Proceedings of the 91st Annual Conference of the National Tax Association*, 1998, pp. 327-340. An updated version of this paper is published as Office of Tax Analysis Paper 82, Defining and Measuring Marriage Penalties and Bonuses, November 1999, which can be accessed at [http://www.ustreas.gov/ota/otapapers.htm].

penalties and bonuses" measured by looking at unmarried cohabitating households would be about 7% of the size of "marriage bonuses and penalties" measured by looking at married households.

Issues Surrounding the Marriage Penalty and Proposed Remedies

Concern about the marriage penalty reflects an obvious reservation about discouraging a social institution such as marriage, and the possible incentives that the law creates for couples to live together without marriage. This issue is likely to be more important for couples without children and in general the legislative remedies address differences between the tax treatment of single and joint returns. For these individuals, the marriage penalty could, in theory, be eliminated by one of the methods discussed above (reducing taxes on joint returns or optional filing). It could also be eliminated, with no revenue cost, by simultaneously increasing the tax burdens on single individuals. Indeed, the marriage penalty only dates from 1969; its development at that time was due to complaints by single individuals that they were being taxed too heavily.

A major issue, therefore, is the equitable treatment of different types of families. There are also, however, questions of administrative feasibility and of what types of tax revisions would most reduce the distortions in the income tax system. In this section, we discuss the issues of equity across families, efficiency, and administrative feasibility. Different legislative approaches fare differently when measured by these criteria. They also involve different revenue costs. For example, it is less expensive, in terms of lost tax receipts, to eliminate the marriage penalty through optional joint filing than it is to reduce tax rates on all joint returns, which would eliminate the marriage penalty, but also transform penalties into bonuses and increase existing bonuses.

Equity Across Family Types

One of the reasons for differences in the rate schedules for singles, heads-of-households, and married couples is to adjust for ability- to-pay. Because of economies of living together (e.g. sharing items), a couple requires more income, but not twice as much income, to achieve the same standard of living as a single individual. Our poverty programs recognize this and measures of the poverty line adjust for this effect. Tax changes that lower taxes, for some or all joint returns, would affect the equity of tax burdens across families. Thus, it is of some interest to explore how existing tax burdens fall on families of different types. Tables 2 and 3 address this issue by using the relative levels of the poverty line to define families of different sizes with equal abilities to pay and calculating effective tax rates. Note that about 40 percent of returns are joint returns (representing, of course, two adults); about 44 percent are single returns, and 14 percent are heads of household. (The remaining two percent are married couples filing separately). Thus, about 57 percent of adults file joint returns, 31 percent file single returns and 10 percent file head of household returns.

In Tables 2 and 3, families in each column have the same ability to pay and under a completely horizontally equitable system (if one could rely on the relative poverty line as a measure of relative ability to pay), these families should have the same effective tax rate; in a progressive system, the effective tax rate would, however, rise across the rows. Looking just at families without children (the single return and joint return with two members, a couple without dependent children), tax burdens tend to be higher on single individuals than on married couples with the same standard of living. Families with children at lower income levels receive better tax treatment because of the child credit and the earned income tax credit, although this effect is reversed at higher income levels. In this case, large families who are phased out of these credits pay taxes at highest rates. But, in general, singles in most cases already pay, by this measure, higher tax rates than those that are justified by ability-to-pay measures. Therefore, one of the consequences of addressing the marriage penalty will be to exacerbate this differential between singles without children and other taxpayers. The difference between joint returns and heads of household are more varied.

Table 2: Average Effective Income Tax Rates by Type of Return, Family Size, and Income: Low and Middle Income Taxpayers

	Income Level for Family of Two				
Type-Size	**$5000**	**$10000**	**$20000**	**$35000**	**$50000**
Single - 1	-0.08	0.02	0.08	0.10	0.12
Joint - 2	-0.07	0.00	0.06	0.10	0.10
Joint - 3	-0.34	-0.18	0.02	0.08	0.09
Joint - 4	-0.40	-0.20	0.03	0.07	0.10
Joint - 5	-0.40	-0.13	0.02	0.07	0.11
Joint - 6	-0.37	-0.10	0.01	0.06	0.11
Joint - 7	-0.33	-0.08	0.00	0.06	0.11
H/H - 2	-0.33	-0.21	0.00	0.08	0.10
H/H - 3	-0.40	-0.30	0.00	0.07	0.10
H/H - 4	-0.40	-0.20	0.02	0.06	0.11
H/H - 5	-0.40	-0.14	0.01	0.06	0.13
H/H - 6	-0.37	-0.10	0.00	0.06	0.13
H/H - 7	-0.33	-0.08	-0.01	0.06	0.14

Source: Congressional Research Service. Data based on relative poverty levels for 1997, U.S. Census Bureau ([http://www.census.gov/hhes/poverty/pre97siz.html]). The dollar amounts refer to the income for a family of two; larger families in each column would have more income and singles would have less income.

Table 3: Average Effective Income Tax Rates by Type of Return, Family Size, and Income: High Income Taxpayers

Income Level for Family of Two				
Type-Size	**$75,000**	**$100,000**	**$200,000**	**$1,000,000**
Single - 1	0.16	0.17	0.21	0.30
Joint - 2	0.13	0.16	0.20	0.28
Joint - 3	0.13	0.16	0.22	0.28
Joint - 4	0.15	0.17	0.24	0.31
Joint - 5	0.16	0.18	0.25	0.31
Joint - 6	0.16	0.19	0.26	0.32
Joint - 7	0.17	0.20	0.27	0.32
H/H - 2	0.18	0.17	0.22	0.28
H/H - 3	0.15	0.17	0.23	0.29
H/H - 4	0.16	0.18	0.25	0.31
H/H - 5	0.17	0.19	0.26	0.31
H/H - 6	0.17	0.20	0.26	0.32
H/H - 7	0.17	0.21	0.27	0.32

Source: Congressional Research Service. Data based on relative poverty levels for 1997, U.S. Census Bureau ([http://www.census.gov/hhes/poverty/pre97siz.html]). The dollar amounts refer to the income for a family of two; larger families in each column would have more income and singles would have less income.

Note also that some approaches to addressing the marriage penalty would expand the differences between joint returns and all other returns (e.g. increasing the bracket widths and standard deductions for joint returns). These changes would lower tax rates of all married couples, and thus increase the disparity shown in Table 2 between singles and married couples without creating differences between married couples. Optional single filing would affect only those with marriage penalties (some two earner families with more even income splits), while second-earner deductions would affect all two-earner couples[8]. Only these joint returns would experience tax reductions, and while provisions that only affect two-earner families would not exacerbate disparities between singles and one earner families, they would create differences between married couples with different degrees of income split. Low income families, however, may not be affected by these changes or affected very little

[8] An argument can be made that one-earner couples are already favored by the additional untaxed time of the non-working spouse who is able to use this time for a variety of purposes including economizing on family costs of living. Two-earner couples with children may also be favored if they are eligible for deductions for child care.

unless changes to address the marriage penalties in the earned income tax credit (EITC) are adopted.

Efficiency

Efficiency can be viewed in two ways: expending the smallest amount of revenue to obtain an objective (target efficiency) and making changes in ways that reduce tax distortions in behavioral choice (economic efficiency).

The most target efficient approach to addressing the marriage penalty would be to allow optional separate filing because it only reduces taxes for those with penalties. It would be possible to restrict the options to singles rate structures and avoid the complications and inefficiencies of allowing married couples with children to file as heads of households. Indeed, it would be possible to have an alternative computation on the joint return that would allow a tax credit for the difference between joint and single rate brackets and standards deductions assuming only standard deductions, and applying only to earned income.

The least target efficient approach would be increasing standard deductions and rate brackets for all joint returns, which would benefit many couples with marriage bonuses and create bonuses for couples who previously had penalties. While not as target efficient as optional filing, a second earner deduction would not benefit the one-earner couples who are responsible for much of the marriage bonus. A variation of this approach can be found in President Clinton's proposal to increase the standard deduction for two-earner joint returns.

While economic efficiency is not the principal issue in the marriage penalty, it is worth noting that there are some ways to alter the marriage penalty that could increase efficiency more than others. For example, one of the distortions that might be relieved by a second-earner deduction is the potential discouragement to work due to the relatively high marginal tax rates faced by married women, who tend to be more responsive to net wages than other workers. These marginal tax rates would also be reduced, but by less per dollar of revenue loss, with provisions for optional single filing. Relief granted to all returns, especially relief that does not affect marginal deductions (such as increasing the standard deduction and, for higher income families, widening the first rate bracket) would not contribute to economic efficiency. Provisions that provided relief for the earned income tax credit would also affect work incentives, but they would probably do so more effectively for relief provided by disregarding a fraction of the secondary earner's salary for purposes of the phaseout, as opposed to electing separate filing or increasing the phaseout ranges for joint returns.

While there is a lot of anecdotal evidence concerning the discouraging effect of the marriage penalty on marriage and its encouragement of divorce, most studies have concluded that these effects are relatively small. The relatively small number of cohabitating couples compared to married couples also lend some support to this view.

Simplicity

Reducing taxes on joint returns by increasing standard deductions and widening rate brackets would have no effect on or simplify the tax law. Optional single filing, however, would complicate tax compliance. Even if the option restricts filing to single rates (eliminating the need to assign children for purposes of head-of-household rates), the need to split unearned income and itemized deductions would add complications and, perhaps, opportunities for tax planning. (It would be possible, however, to provide a version of optional filing by providing a tax credit for the difference between filing jointly and as singles on earned income assuming standard deductions). A second-earner deduction would add another line on the tax return, but would not be very complicated.

Conclusion

Any approach to addressing the marriage penalty seems likely to exacerbate or create horizontal inequities based on ability to pay. It is difficult to evaluate alternative proposals using this standard. Some proposals, such as optional separate filing, are more target efficient than others, or contribute more to economic efficiency, but these proposals also are likely to be the least simple. Increasing standard deductions and bracket widths on joint returns is least efficient, but also the simplest approach. The second-earner deduction, which was part of prior tax law, falls between the two alternatives in both target efficiency and administrative complications.