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The Marriage Penalty

Many married couples pay more taxes than they would if they were unmarried. This penalty can amount to several thousand dollars per year even for moderate-income families. President Clinton's tax increase in 1993 made the problem worse. The House Republicans' Contract With America proposes abolishing the marriage penalty altogether.

The History of the Penalty. Prior to 1948, the tax code made no distinction between married couples and individuals. In that year, Congress changed the law to allow income splitting. In effect, couples were taxed like two single taxpayers even if only one earned income. The result was to sharply lower tax rates for married couples. In short, a de facto subsidy for marriage was created.

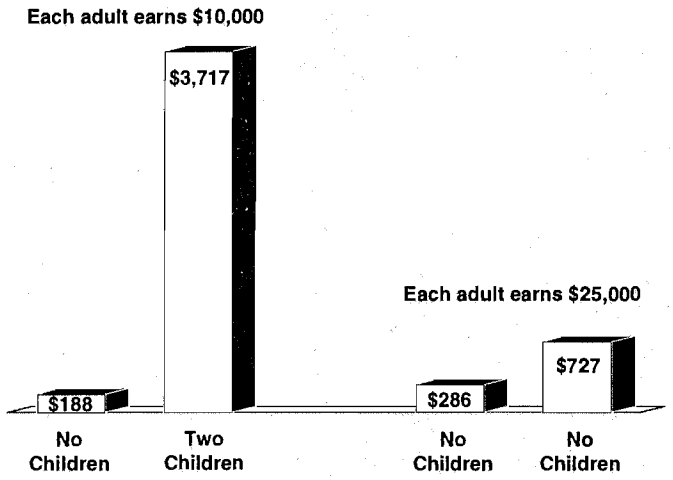
By 1969 the magnitude of this subsidy had grown to such an extent that it was possible for a single person to pay 40 percent more in taxes than a married couple with the same income. This led Congress to create, for married and unmarried people, separate tax schedules designed to reduce the subsidy to no more than 20 percent.

An unintended consequence of the 1969 law change was to create a marriage penalty for the first time. The penalty was most likely to emerge when a married couple both worked. This is important because in the early 1970s there was a sharp increase in the number of women working, with fewer remaining as unpaid homemakers. In 1969 the female labor force participation rate was 42.7 percent; by 1979 the rate had risen to 50.9 percent. Thus as more women entered the labor force, an increasing number of couples were subject to the marriage penalty.

Why Is There a Penalty? The basic reason is that we have progressive tax rates. In effect, the second earner in a family (the lower paid of the two) has his or her income added to that of the primary earner and thus is often taxed at a higher marginal rate. For example, under current law, if the primary earner had $22,000 of taxable income, he or she would pay tax at a 15 percent rate on that income. If the secondary earner also made $22,000, this would put the family's total income into the next higher tax bracket and the secondary worker would pay 28 percent on the last $4,000 of his or her income. The marriage tax would amount to $520, the difference between 15 percent and 28 percent on the couple's income above $38,000, which is the cutoff for the 15 percent bracket. Were they unmarried, both would pay just 15 percent on all their income.

FIGURE I

The Marriage Penalty



Source: Daniel R. Feenberg and Harvey S. Rosen, "Recent Developments in the Marriage Tax," National Bureau of Economic Research Working Paper No. 4705 (April 1994), p. 20.

Congress's first response was to create a special tax deduction in 1981. It allowed couples with two incomes to deduct 10 percent of the earnings of the lower-paid spouse in addition to the other deductions they were entitled to. In 1986, Congress replaced the two-earner deduction with a new standard deduction designed to eliminate the marriage penalty. Although these changes substantially mitigated the penalty, in 1988 some 40 percent of families still paid for being married — a tax price that averaged $1,100.

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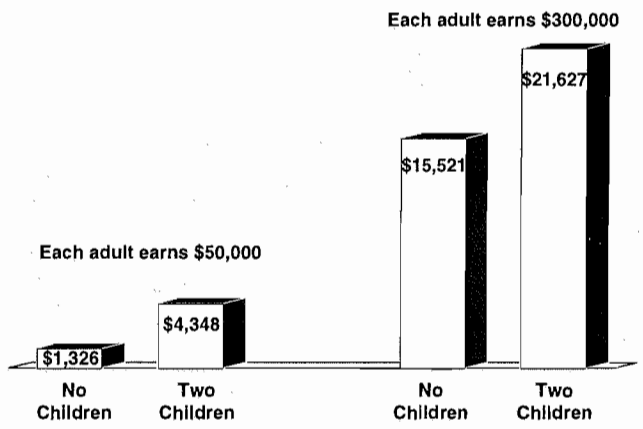
Adding to the Burden. President Clinton's 1993 tax increase exacerbated the marriage penalty problem by creating two new tax brackets, a 36 percent rate beginning at $140,000 of income for married couples and a "millionaires' surtax" of 39.6 percent, which starts at $250,000 of income. These new brackets create more opportunities for the secondary earner to be pushed into a higher tax bracket than if he or she were single.

In addition, changes in the Earned Income Tax Credit (EITC) enacted in 1993 also had the effect of increasing the marriage penalty. This is because as the credit is phased out it creates a higher de facto marginal tax rate of 21 percent. According to *Forbes* magazine (November 7, 1994), by 1996 a married couple with four children and income of $11,000 each would get a credit of $1,375. However, if the couple split and each took two children, both would be entitled to a credit of $3,560. Thus they would have a total credit of $7,120, or a $5,745 reward for getting divorced. On a total income of $22,000 per year, their penalty for being married would be enormous.

FIGURE II

The Marriage Penalty



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The Child Penalty. The Clinton tax changes increased the marriage penalty for the rich and the poor. Those in the middle were largely unaffected. But the changes also penalized married couples with children more than those without children.

Take a couple each earning $10,000 a year. As Figure I shows, if they have no children, the marriage penalty is $188. If they have two children, the penalty soars to $3,717. That is a tax of $1,265 per child

As Figure II illustrates, the penalty for a couple earning $50,000 each is $1,326 if they have no children and $4,348 if they have two — a penalty of $1,511 per child. And a couple earning $300,000 each pays a penalty of $15,521 if they have no children and $21,627 if they have two — a penalty of $3,053 per child.

Abolishing the Penalty. The Republican Contract With America has proposed eliminating the marriage penalty altogether. Since the penalty results partly from the effects of a tax subsidy program, the net cost of eliminating it would be only about $6 billion on a static basis. But since this effectively would entail abolishing the EITC, it is not likely to be done because it would constitute a large tax increase on the poor. If the penalty were eliminated only for those with a positive tax liability, the cost would be $33 billion. The latest increase, obtained by Clinton, could be repealed for $10 billion.

In the end, the only sure way of abolishing the marriage penalty may be to abolish progressivity altogether and institute a flat-rate income tax, such as that proposed by Rep. Dick Armey.

This Brief Analysis was prepared by NCPA Senior Fellow Bruce Bartlett.