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The Marriage Penalty: A Tax On Working Couples

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The most significant change in the U.S. labor force in the last 60 years has been the increasing participation of women. Women now account for 46 percent of the total U.S. workforce, and nearly half of married women with children (47 percent last year) work.

As more married women have entered the labor force, working couples have been affected by the peculiarities of the federal Tax Code that create what is called a marriage penalty. A marriage penalty results when a married couple pays more in federal income taxes than they would if they were unmarried and each were taxed as a single or head of household filer. The marriage penalty affects only two-earner couples. No single-earner couples ever pay a marriage penalty. Conversely, a marriage bonus occurs when a couple pays less federal income tax filing jointly than they would if they were unmarried and filed as a single or head of household. For the most part, single-earner couples receive substantial bonuses from the Tax Code.

A Penalty on Work. The so-called marriage penalty is less a penalty on marriage than a penalty on work by the secondary earner. This is usually the wife, but increasingly the husband. According to the Census Bureau, 22.3 percent of married women earned more than their husbands in 1999, up from 15.9 percent in 1981.

A Treasury Department paper shows the magnitude of the marriage penalty problem.

- According to the study, 25 million couples — 48 percent of all joint filers — paid a penalty in 1999 for being married. [See the Figure.]
- Collectively, they paid $28 billion more because of the marriage penalty, averaging $1,141 per couple.

Marginal Tax Rate on Labor. The marriage penalty results mainly from steeply progressive tax rates. In effect, the lower-paid spouse is taxed at the higher-paid spouse's marginal tax rate — the tax applied to the last dollar of income. For example, a husband and wife whose individual earnings would put both in the 15 percent federal tax bracket if taxed as singles will often find that their combined earnings push some or all of the lower-paid spouse's earnings into the 28 percent bracket.

Other provisions of the Tax Code that also give rise to a marriage penalty are the standard deduction and the Earned Income Tax Credit.

- A standard deduction of $4,400 for tax year 2000 is available to each of two individuals filing separately, but a couple filing jointly is limited to $7,350 and pays tax on the $1,450 difference.
- The higher combined earnings of a married couple trigger a phase-out of the Earned

Income Tax Credit sooner.

It is estimated that more than 60 different provisions of the Tax Code cause tax liability to vary with marital status.

Discouraging Work. The most important economic effect of the marriage penalty is on the labor force participation rates of the lower-earning spouse in two-earner families. A large body of economic literature, as well as anecdotal evidence, indicates that such earners (lower-paid spouses) are much more sensitive to marginal tax rates than are primary earners. For example, economists Martin Feldstein and Daniel Feenburg found in 1996 that sharply cutting the tax rate on secondary earnings could lead to an increase in earnings by such workers of as much as $66 billion a year.

House Version of Bush Plan. President Bush proposed that Congress reinstitute a Reagan-era deduction for the income of a secondary earner that had substantially mitigated the marriage penalty. Enacted in 1981 and repealed in 1986, this provision saved couples up to $3,000 in taxes on the income of the lower-paid spouse. The House of Representatives recently passed legislation that takes a different approach. While this bill would relieve some of the marriage penalty, it also would increase the marriage bonus for nonworking spouses by treating two-earner couples and single-earner couples similarly.

The House-passed provisions would:

- Increase the standard deduction for married couples — both single- and dual-income earners — to twice that for singles.
- For couples who itemize deductions, gradually raise the amount of income covered by the 15 percent tax bracket to twice that for single people.
- For low-income working couples, raise the limit on the amount they could earn and still be entitled to the Earned Income Tax Credit.

While it is true that the current break points for the standard deduction contribute to the marriage penalty, doubling the standard deduction would offset only about one-fourth of the total marriage penalty. Moreover, almost half the benefits, in terms of tax savings, would go to couples who pay no marriage penalty. In short, the House-passed bill provides a general tax cut for married couples with low incomes — or at least those who do not itemize — rather than relief from the marriage penalty.

Doubling the amount of income in the 15 percent tax rate bracket for married couples, including those with nonworking spouses, while leaving the income bracket unchanged for singles, would increase the disparity in the tax burden between couples and singles. It was Congress's attempt to reduce disparity in the tax burden on the identical incomes of single taxpayers compared with married couples that led to the marriage penalty in the first place!

Making the House Bill Better. To really get rid of the marriage penalty, Congress must allow couples to choose their filing status. That is, they could continue to file jointly or with each spouse filing as a single, depending on which way they would pay less in taxes. Of course, there are important administrative and technical problems with this approach. For example, regulations would have to specify how income and deductions from jointly held assets are to be divided. There is also the question of who gets the personal exemption and tax credit for the children.

These issues can be resolved. The real problem is that once we have adopted a system in which couples can choose their filing status, it will become clear that the sensible thing to do would be to adopt a system in which the individual, rather than the family, is the basic unit of taxation. This has been advocated for some years by a number of tax theorists.

Conclusions. Work, saving and investment decisions are all made at the margin. Thus the tax rate on the marginal dollar — the last dollar earned — is the critical one for economic decision making. Because deductions affect marginal tax rates by raising the income level affected by higher rates, raising the standard exemption would improve incentives. And increasing the lowest income tax bracket for working couples would reduce both the income tax burden and marginal tax rates faced by lower-income couples. However, a more efficient remedy to the marriage penalty would be to let working couples choose their filing status.

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