PRESENT LAW AND BACKGROUND

RELATING TO PROPOSALS TO REDUCE

THE MARRIAGE TAX PENALTY

Scheduled for a Public Hearing

Before the

HOUSE COMMITTEE ON WAYS AND MEANS

on January 28, 1998

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The House Committee on Ways and Means has scheduled a public hearing on proposals relating to the Federal "marriage tax penalty" on January 28, 1998. This document,[(1)] prepared by the staff of the Joint Committee on Taxation, provides a discussion of present law, legislative history, certain legislative proposals, and analysis of issues related to the Federal income tax treatment of married taxpayers.

Part I of the document is a description of present law and legislative history on the marriage tax penalty. Part II is a description of certain House legislative proposals (H.R. 2456 and H.R. 2593), and Part III is an analysis of issues. The Appendix presents an equation related to tax progressivity, equal taxation of couples with equal income, and marriage neutrality.

I. PRESENT LAW AND BACKGROUND

A. Present Law

In general

A marriage penalty exists when the sum of the tax liabilities of two unmarried individuals filing their own tax returns (either single or head of household returns) is less than their tax liability under a joint return (if the two individuals were to marry). A marriage bonus exists when the sum of the tax liabilities of the individuals is greater than their combined tax liability under a joint return.

While the size of any marriage penalty or bonus under present law depends upon the individuals' incomes, number of dependents, and itemized deductions, as a general rule married couples whose earnings are split more evenly than 70-30 suffer a marriage penalty. Married couples whose earnings are largely attributable to one spouse generally receive a marriage bonus. Although the marginal tax rate breakpoints[(2)] and the standard deduction are typically considered the major elements of the Federal income tax system that create marriage penalties and bonuses, other provisions of present law also contribute to the amount of marriage penalty or bonus any couple will face.

Rate brackets and standard deduction

Under present law, the size of the standard deduction and the bracket breakpoints for the 15-, 28- and 31-percent brackets follow certain customary ratios across filing statuses. The standard deduction and bracket breakpoints for single filers are roughly 60 percent of those for joint filers. The standard deduction and bracket breakpoints for head of household filers are about 83 percent of those for joint filers. With these ratios, unmarried individuals have standard deductions whose sum exceeds the standard deduction they would receive as a married couple filing a joint return. Thus, their taxable income as joint filers may exceed the sum of their taxable incomes as unmarried individuals. Furthermore, because of the way the bracket breakpoints are structured, as joint filers they may have some of their taxable income pushed into a higher marginal tax bracket than when they were unmarried.

The rate changes in the Omnibus Budget Reconciliation Act of 1993 (OBRA '93) exacerbated the existing marriage penalty because the new bracket breakpoints did not provide the customary ratios across filing statuses. For the 36-percent bracket, the breakpoint for single filers and for head of household filers are 82 percent and 91 percent, respectively, of the breakpoint for joint filers. In addition, unlike the other bracket breakpoints, the threshold for the 39.6-percent tax rate is the same for all filing statuses, $278,450 in 1998. To eliminate the marriage penalty caused by the rate structure, the standard deduction and bracket breakpoints for all unmarried filers would have to be 50 percent of those for joint filers. This is the current ratio for individuals who are married, but file separate returns.(3)

Other marriage penalties and bonuses under present law

A marriage penalty or bonus can occur under other provisions of present law. For example, a marriage penalty or bonus can occur when a provision allows for different thresholds for the treatment of married taxpayers relative to single taxpayers. For example, the provision of present law that requires a portion of social security benefits to be included in income can create either a marriage penalty (because it is possible that one spouse's taxable income may require the other spouse's social security benefits to be included in income) or a marriage bonus (because spouses with relatively unequal incomes may have less social security benefits included in income than if the spouses were not married).

A marriage penalty or bonus can also be created under present law when a provision does not provide different treatment for married couples relative to single individuals. For example, the present-law dependent care credit phases down beginning at adjusted gross income of $10,000, irrespective of whether the taxpayer is married or not. The dependent care credit can create a marriage penalty because the combined income of a married couple may make the couple eligible for a smaller credit than if the couple were both single taxpayers. The dependent care credit can create a marriage bonus because a full-time student with no earned income may be entitled to the credit if married to a taxpayer with earned income, but would not be entitled to the credit if single.

Additional facets of present law such as the limitation on itemized deductions, the phaseout of personal exemptions, the phaseout of the child credit credits, and the phaseouts provided for various provisions can exacerbate the marriage penalty or bonus.

Marriage penalty and low-income taxpayers

Developments subsequent to 1970 have added additional facets to the marriage penalty that primarily affect lower-income taxpayers. There are three features of the current individual income tax system that create a marriage penalty for low-income individuals: the variation of the size of the standard deduction by filing status, the phaseout of the earned income credit (EIC) as income increases, and the variation of the size of the EIC by number of dependent children.(4)

Because the EIC increases over some range of income and then is phased out over another range of income, the aggregation of incomes that occurs when two individuals marry may reduce the amount of EIC for which they are eligible.(5)

Marriage may reduce the size of a couple's EIC not only because their incomes are aggregated, but also because the number of dependent children is aggregated. Because the amount of EIC does not increase when a taxpayer has more than two dependent children, marriages that cause the resulting family to have more than two dependent children will result in a smaller number of children giving rise to the EIC than when their parents were unmarried. And even when each unmarried individual brings just one dependent child into the marriage there is a reduction in the amount of EIC, since the maximum credit for two children is generally much less than twice the maximum credit for one child.

These three features can cause unmarried individuals who are eligible for the EIC to face significant marriage penalties. For example, in 1998, two individuals each with one dependent child, one with wage income of $14,000 and the other with wage income of $10,000, would face a marriage penalty of $3,095(6) due to the EIC.(7)

B. Legislative History

The marriage penalty in the current income rate structure dates from changes in the structure of individual income tax rates in 1969.(8) To understand the effect of those changes, one needs to go back to 1948, when separate rate schedules for joint filers and single returns were introduced. Before 1948, there was only one income tax schedule, and all individuals were liable for tax as separate filing units. Under this tax structure, there was neither a marriage penalty nor a marriage bonus. However, this structure created an incentive to split incomes because with a progressive income tax, a married couple with only one spouse earning income could reduce its combined tax liability if it could split the income and assign half to each spouse. While the Supreme Court upheld the denial of contractual attempts to split income,(9) it ruled that in States with community property laws, income splitting was required for community income.(10) As income tax rates and the number of individuals liable for income taxes increased before and during World War II, some States adopted, or considered adopting, community property statutes to give their citizens the tax benefits of income splitting.

The Revenue Act of 1948 provided the benefit of income splitting to all married couples by establishing a separate tax schedule for joint returns. That schedule was designed so that married couples would pay twice the tax of a single taxpayer having one-half the couple's taxable income. (This relationship between rate schedules is the same as that between joint returns and separate returns for married couples under present law.) While this new schedule equalized treatment between married couples in States with community property laws and those in States with separate property laws, it introduced a marriage bonus into the tax law for couples in States with separate property laws.(11) As a result of this basic rate structure, by 1969, an individual with the same income as a married couple could have had a tax liability as much as 40 percent higher than that of the married couple. To address this perceived inequity, which was labeled a "singles penalty" by some commentators, a special rate schedule was introduced for single taxpayers (leaving the old schedule solely for married individuals filing separate returns). The bracket breakpoints and standard deduction amounts for single taxpayers were set at about 60 percent of those for married couples filing joint returns. This schedule created a marriage penalty for some taxpayers.

In 1981, Congress created a deduction for two-earner married couples. The maximum deduction equaled 10 percent of the lesser of: (1) the earned income of the spouse with lower income or (2) $30,000. The two-earner deduction, was, in part, created to alleviate the work disincentive effects of high marginal tax rates on the second earner's income. The Tax Reform Act of 1986 repealed the two-earner deduction in conjunction with the enactment of generally lower tax rates.

II. DESCRIPTION OF PROPOSALS

A. Election to Calculate Combined Tax as Individuals (H. R. 2456--Mr. Weller and others)[12]

Under this proposal, married taxpayers would have the option to calculate separate taxable income for each spouse and to be taxed as two single individuals on the same return. The tax due would be calculated by applying the tax rates for single individuals to the separate taxable incomes.[13]

Income from the performance of services (e.g., wages, salaries, and pensions) would be treated as the income of the spouse who performed the services. Income from property would be divided between the spouses in accordance with their respective ownership rights in such property.[14]

Deductions generally would be allocated to the spouse treated as having the income to which the deduction relates. Special rules would apply for certain deductions. The deduction for contributions to an individual retirement arrangement would be allocated to the spouse for whom the contribution is made. The deduction for alimony would be allocated to the spouse who has the liability to pay the alimony. The deduction for contributions to medical savings accounts would be allocated to the spouse with respect to whose employment or self employment the account relates.

Each spouse would be entitled to claim one personal exemption. Exemptions for dependents would be allocated based on each spouse's relative incomes.

The standard deduction would apply to each spouse as if they were not married.

All credits would be based on the combined tax of the couple.

Except as otherwise provided in the proposal or in regulations, a combined return under the proposal would be treated as a joint return.

The Secretary of the Treasury would be direct to prescribe such regulations as may be necessary or appropriate to carry out the provisions of the bill.

Effective date.--The proposal would be effective for taxable years beginning after the date of enactment.

B. Second Earner Deduction[15] (H.R. 2593--Mr. Herger and others)[16]

Under the bill, two-earner married couples who file a joint return would be entitled to a deduction in arriving at adjusted gross income (i.e., "above-the-line") equal to 10 percent of the lesser of (1) the qualified earned income of the spouse with the lesser earned income (or either spouse if their incomes are the same), and (2) $30,000. Thus, the maximum deduction would be $3,000. The deduction would not apply for a year if either spouse claimed the exclusion for foreign earned income (sec. 911) or for income earned from sources within Guam, American Samoa, or the Northern Mariana Islands (sec. 931).

In general, qualified earned income would be earned income, less certain deductions attributable to that income. Qualified earned income would be determined without regard to community property laws; that is, earned income would be attributed to the spouse who renders the services for which the earned income is received.

Pensions, annuities, distributions from individual retirement arrangements, and deferred compensation would be excluded from qualified earned income. Also, wages exempt from social security taxes because an individual is in the employ of his or her spouse would be excluded from qualified earned income.

Certain items would be deducted in computing qualified earned income. These items would be: (1) deductions attributable to a trade or business from which the earned income is derived (except that if some of the gross income from the trade or business does not constitute earned income, only a proportional share of the deductions attributable to such trade or business would be deducted); (2) deductions consisting of certain expenses paid or incurred in connection with the performance of services as an employee; (3) deductions for contributions by self-employed individuals to a qualified retirement plan; (4) deductions for contributions to an individual retirement arrangement; and (6) deductions for certain repayments of supplemental unemployment compensation benefits.

Effective date.--The proposal would be effective for taxable years beginning after the date of enactment.

III. ANALYSIS

Data relating to marriage penalty under present law

There is no precisely accurate measure of the size of the marriage penalty or bonus under present law. The amount of penalty or bonus that any married couple will face depends on the particular characteristics of the couple's income, deductions, credits, etc, and how such items of income, etc., are assumed to be divided between the spouses. Nevertheless, it can be said that many households are affected by the marriage penalty or marriage bonus. One study estimated that in 1994, 52 percent of married couples would face a marriage penalty, with an average penalty of about $1,244, while 38 percent would face a marriage bonus, with an average bonus of about $1,399.(17)

The Congressional Budget Office ("CBO") estimated that in 1996, the marriage penalty under present law under one set of assumptions was estimated to aggregate to $28.8 billion for 20.9 million returns (42 percent of couples). The marriage bonus was estimated to aggregate to $32.9 billion for 25.3 million returns (51 percent of couples), and 3.1 million returns (6 percent of couples) were estimated to have neither a marriage penalty or bonus. Under this set of assumptions, the 20.9 million returns with a marriage penalty had an average penalty of $1,380 and the 25.3 million returns with a marriage bonus had an average bonus of $1,300. Under an alternative set of assumptions, the marriage penalty for 1996 was estimated to be $18.1 billion for 18.5 million returns and the marriage bonus was estimated to be $42.2 billion for 27.7 million returns. Under a third set of assumptions, the marriage penalty for 1996 was estimated to be $17.0 billion for 17.8 million returns and the marriage bonus was estimated to total $33.2 billion for 27.3 million returns.(18) The CBO analysis also reported that lower-income couples are more likely to receive marriage bonuses and higher-income couples are more likely to incur marriage penalties. The study estimated that in 1996 couples with AGI less $50,000 (56 percent of all couples) comprised 63 percent of bonus recipients and 44 percent of couples incurring penalties. Couples with AGI greater than $50,000 comprised 37 percent of bonus recipients and 56 percent of couples incurring penalties.(19)

Below are "contour maps" (Figures 1-4) showing the size of marriage penalties and bonuses for individuals of different filing statuses under projected tax schedules for 1998. Figure 1 reflects the penalty or bonus for two single filers marrying. Figures 2 and 3 reflect the marriage penalty or bonus for a single filer marrying a head of household filer with one or two dependents. For all of these calculations, all of the income of the individuals is assumed to be earned income, and it is assumed that the standard deduction is taken. The separate income of one spouse is shown on the horizontal axis, the separate income of the other spouse is shown on the vertical axis. The point at the intersection of two income levels indicates the marriage penalty or bonus for the couple. Marriage penalties are shown as positive numbers in the map, marriage bonuses are shown as negative numbers.

[FIGURE 1 NOT AVAILABLE IN ON-LINE VERSION]

[FIGURE 2 NOT AVAILABLE IN ON-LINE VERSION]

[FIGURE 3 NOT AVAILABLE IN ON-LINE VERSION]

[FIGURE 4 NOT AVAILABLE IN ON-LINE VERSION]

It was previously stated that, in general, couples with incomes more evenly split than 70-30 would suffer a marriage penalty, and those with incomes less evenly split than 70-30 would benefit from a marriage bonus. This rule of thumb is a result of the fact that the bracket breakpoints for single taxpayers were customarily set at levels that were approximately 60 percent of the breakpoints for married taxpayers. Figure 4, which is a replica of Figure 1 with the addition of two lines that indicate the exact 70-30 income split, helps to illustrate the rule of thumb. The area between these two lines shows where income is more evenly split than 70-30, and is thus the area where we expect to see a marriage penalty. The areas to the outside of the two lines indicate incomes less evenly split than 70-30, and thus by the 70-30 rule of thumb we should expect the contour maps to indicate marriage bonuses in these areas. However, these lines help show that the contour maps indicate that the 70-30 rule becomes increasinly less accurate as the income of the higher earning spouse rises above $60,000 or so. That is, beyond $60,000, increasing amounts of the area to the outside of the 70-30 lines are areas of penalty rather than bonus. The principal reason for this is that the bracket breakpoints for the 36 percent and 39.6 percent brackets for single filers were not set at the customary level of 60 percent of the breakpoint for married taxpayers filing jointly, but rather at 82 percent and 100 percent of the corresponding breakpoints for joint returns. The result is that the marriage penalty is greatly increased for upper income single taxpayers who marry. Hence, the contour maps show a much wider swath of taxpayers affected by the marriage penalty than the 70-30 rule would indicate. The phaseout of personal exemptions also contributes to the marriage penalty at high incomes.

Figures 2 and 3, which show marriage penalties for a head of household filer and a single filer that marry, also do not conform to the 70-30 rule of thumb. However, the 70-30 rule of thumb is based on two single filers marrying and was never meant to apply to the situation of a head of household marrying a single taxpayer. Under those marriage circumstances the marriage penalty is typically larger because one taxpayer already has the advantage of the relatively favorable filing status of head of household, where the bracket breakpoints are customarily set at 83 percent of those for joint returns. Giving up this filing status to marry thus results in a greater marriage penalty relative to giving up the single filing status to marry. The contour maps reflect this, as they indicate a much wider swath of marriage penalties than that for two singles marrying.

Marriage neutrality versus equal taxation of married couples with equal incomes

Any system of taxing married couples requires making a choice among three different concepts of tax equity.

One concept is that the tax system should be "marriage neutral;" that is, the tax burden of a married couple should be exactly equal to the combined tax burden of two single persons where one has the same income as the husband and the other has the same income as the wife. A second concept of equity is that, because married couples frequently consume as a unit, couples with the same income should pay the same amount of tax regardless of how the income is divided between them. (This second concept of equity could apply equally well to other tax units that may consume jointly, such as the extended family or the household, defined as all people living together under one roof.) A third concept of equity is that the income tax should be progressive; that is, as income rises, the tax burden should rise as a percentage of income.

These three concepts of equity are mutually inconsistent. A tax system can generally satisfy any two of them, but not all three.(20) The current tax system is progressive: as a taxpayer's income rises, the tax burden increases as a percentage of income. It also taxes married couples with equal income equally: it specifies the married couple as the tax unit so that married couples with the same income pay the same tax. But it is not marriage neutral.(21) A system of mandatory separate filing for married couples would sacrifice the principle of equal taxation of married couples with equal incomes for the principle of marriage neutrality unless it were to forgo progressivity. It should be noted, however, that there is an exception to this rule if refundable credits are permissible. A system with a flat tax rate and a per taxpayer refundable credit would have marriage neutrality, equal taxation of couples with equal incomes, and progressivity.(22)

There is disagreement as to whether equal taxation of couples with equal incomes is a better principle than marriage neutrality.(23) Those who hold marriage neutrality to be more important argue that tax policy discourages marriage and encourages unmarried individuals to cohabit without getting married, thereby lowering society's standard of morality. Also, they argue that it is simply unfair to impose a marriage penalty even if the penalty does not actually deter anyone from marrying.

Those who favor the principle of equal taxation of married couples with equal incomes argue that as long as most couples pool their income and consume as a unit, two married couples with $20,000 of income are equally well off regardless of whether their income is divided $10,000-$10,000 or $15,000-$5,000. Thus, it is argued, those two married couples should pay the same tax, as they do under present law. By contrast, a marriage-neutral system with progressive rates would involve a larger combined tax on the married couple with the unequal income division. The attractiveness of the principle of equal taxation of couples with equal incomes may depend on the extent to which married couples actually pool their incomes.(24)

An advocate of marriage neutrality could respond that the relevant comparison is not between a two-earner married couple where the spouses have equal incomes and a two-earner married couple with an unequal income division, but rather between a two-earner married couple and a one-earner married couple with the same total income. Here, the case for equal taxation of the two couples may be weaker, because the non-earner in the one-earner married couple benefits from more time that may be used for unpaid work inside the home, child care, other activities or leisure. It could, of course, be argued in response that the "leisure" of the non-earner may in fact consist of necessary job hunting or child care, in which case the one-earner married couple may not have more ability to pay income tax than the two-earner married couple with the same income.

Marriage penalty, labor supply, and economic efficiency

Most analysts discuss the marriage penalty or marriage bonus as an issue of fairness, but the marriage penalty or bonus also may create economic inefficiencies. The marriage penalty or bonus may distort taxpayer behavior. The most obvious decision that may be distorted is the decision to marry. For taxpayers for whom the marriage penalty exists, the tax system increases the "price" of marriage. For taxpayers for whom the marriage bonus exists, the tax system reduces the "price" of marriage. Most of what is offered as evidence of distorted choice is anecdotal. There is no statistical evidence that the marriage penalty or marriage bonus has altered taxpayers' decisions to marry. Even if the marriage decision were distorted, it would be difficult to measure the cost to society of delayed marriages or alternative family structures.

Some analysts have suggested that the marriage penalty may alter taxpayers' decisions to work. As explained above, a marriage penalty exists when the sum of the tax liabilities of two unmarried individuals filing their own tax returns (either single or head of household returns) is less than their tax liability under a joint return (if the two individuals were to marry). This is the result of a tax system with increasing marginal tax rates. The marriage penalty not only means the total tax liability of the two formerly single taxpayers is higher after marriage than before marriage, but it also generally may result in one or both of the formerly single taxpayers being in a higher marginal tax rate bracket. That is, the additional tax on an additional dollar of income of each taxpayer is greater after marriage than it was when they were both single. Economists argue that changes in marginal tax rates may affect taxpayers' decisions to work. Higher marginal tax rates may discourage household saving and labor supply by the newly married household. For example, suppose a woman currently in the 28-percent tax bracket marries a man who currently is unemployed. If they had remained single and the man became employed, the first $6,950 of his earnings would be tax free.(25) However, because he marries a woman in the 28-percent income tax bracket, if he becomes employed he would have a tax liability of 28 cents on his first dollar of earnings, leaving a net of 72 cents for his labor. Filing a joint return may distort the man's decision regarding whether to enter the work force. If he chooses not to work, society loses the benefit of his labor. Some have suggested that the labor supply decision of the lower earner or "secondary earner" in married households may be quite sensitive to the household's marginal tax rate.(26)

The possible disincentive effects of a higher marginal tax rate on the secondary worker arise in the case of couples who experience a marriage bonus as well. In the specific example above, the couple consisted of one person in the labor force and one person not in the labor force. As noted previously, such a circumstance generally results in a marriage bonus. By filing a joint return, the lower earner may become subject to the marginal tax rate of the higher earner. By creating higher marginal tax rates on secondary earners, joint filing may discourage a number of individuals from entering the work force or it may discourage those already in the labor force from working additional hours.(27)

Eliminating or reducing the marriage penalty

The marriage penalty could be eliminated in two ways. One is through restructuring of rates (across different filing statuses) and phaseout ranges (for numerous provisions). The other is by giving married couples the option to calculate their tax liability as if they were unmarried. The revenue effects of the marriage penalty are sizable.

To eliminate the marriage penalty through a change in the rate structure, the brackets for all unmarried taxpayers (both singles and heads of household) would have to be half as large as the married, filing joint brackets. This change could either gain or lose revenue--depending on whether unmarried individuals have their rate brackets shifted down or joint filers have theirs shifted up. Another effect of such a step would be that single individuals and heads of household with identical incomes would find their tax liabilities nearly the same (they would differ only because of extra personal exemptions for the head of household's dependents and any EIC). Relying solely on extra personal exemptions to adjust for family size would result in unmarried individuals with dependents receiving smaller tax benefits than they now receive by filing as head of household. Such a change in rate structure would also bring back the "singles penalty" that led to the creation of an unmarried filing status (separate from married, filing separately) in 1969.

Allowing joint filers the option of calculating a combined tax liability as if they were not married would eliminate the problem of the marriage penalty at the cost of complicating the tax return. To take advantage of the provision, taxpayers would have to calculate their tax liability under two alternatives and then choose the smaller liability. Either rules would have to prescribe how taxpayers would allocate deductions and dependent exemptions (if any) between the two spouses or the spouses could be allowed to allocate them in the most favorable manner. In many cases, it would be difficult for the Internal Revenue Service to enforce detailed rules short of audit; in practice, taxpayers could have wide latitude to allocate deductions and unearned income in the most favorable way.[28]

A second issue for the optional unmarried filing is what filing status to allow taxpayers with dependents to use. Should married filers be allowed to file as heads of household on the grounds that they could get divorced and do so? Or should they be constrained to file using the single rate schedules? The answer depend upon the frame of reference. If one measures the marriage penalty relative to what tax treatment the spouses would get if they divorced, then head of household filing is appropriate. If one measures the marriage penalty relative to the tax treatment before the time of marriage, then the answer hinges upon whether the dependents arose before or after the marriage.

An alternative approach would be to reduce the marriage penalty by returning to the 1982-1986 second-earner deduction, which allowed joint filers a deduction for 10 percent of the lesser of the earned income of the lower-earning spouse or $30,000. This approach reduces the marginal tax rate on the lower-earning spouse, but does not eliminate the marriage penalty, especially if the size of the deduction is capped, as was the 1982-1986 deduction. While this approach is not tailored to the particular situation of a married couple, it is much easier to administer than calculating separate liabilities for each spouse. Because it is a deduction, its value rises as the couple's marginal tax rate rises. This feature does not necessarily track the size of the marriage penalty, which is much larger for individuals in the bottom (in relative terms) and top (in dollar amounts) marginal tax brackets. Also, a second-earner deduction provides a tax benefit even if the couple suffers no marriage penalty (*i.e.*, those couples where the earnings are split less evenly than 70/30 as previously discussed).

APPENDIX

The inconsistency of progressivity, equal taxation of couples with equal income and marriage neutrality can be shown mathematically as follows: Consider four individuals, A, B, C and D. Assume that A and B have equal incomes, C has an income equal to the combined incomes of A and B, and D has no income. Let T(A), T(B), and T(C) be the tax burdens of the three individuals with income. If the tax system is not proportional,

(1)

$$T(C) \text{ does not equal } T(A) + T(B)$$

Now assume A and B marry each other, as do C and D, and let T(AB) and T(CD) be the tax burdens of the married couples. The principle that families with the same income should pay the same tax requires that

(2)

$$T(AB) = T(CD),$$

and marriage neutrality requires both that

(3)

$$T(A) = T(B) = T(AB)$$

and that

(4)

$$T(CD) = T(C)$$

Substituting (3) and (4) into (2) yields

(5)

$$T(A) + T(B) = T(C)$$

This, however, contradicts equation (1), indicating that equations (2) and (3) can only both be true in a proportional tax system.

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1. This document may be cited as follows: *Present Law and Background Relating to Proposals to Reduce the Marriage Tax Penalty* (JCX-1-98), January 27, 1998.

2. A bracket breakpoint is the dividing point between two marginal rate brackets.

3. Note that even with such a rate structure, a marriage bonus would exist in the case of an individual with no taxable income marrying an individual with taxable income. The individual with no taxable income is, in essence, allowing some of his or her standard deduction to go "unused." By marrying an individual with taxable income, some of the taxable income of the couple can be reduced by the "unused" portion of the standard deduction.

4. For a more detailed discussion of the marriage penalty and low-income households under present law, see Joint Committee on Taxation, *Background and Information Relating To Three Tax Cut Proposals for Middle-Income Americans: A $500 Per-Child Tax Credit, A Reduction in the Marriage Penalty, and a Deduction for Education and Job Training Expenses* (JCX-7-95), March 1, 1995.

5. In the case of two individuals with very low wage income, marriage may increase the amount of the EIC available for a dependent child. If the individual with the dependent child is in the phase-in range of the EIC, the aggregation of incomes upon marriage could increase the amount of the EIC.

6. The individual with $14,000 in wage income would have a regular tax liability of $352.50 before credits. The $400 nonrefundable child credit would reduce this liability to 0, and the remainder of the credit would go unused since it is a nonrefundable credit. Additionally, an EIC of $1,993 would be allowed, for a net Federal tax liability of -$1,993. The $10,000 wage earner would have no regular tax liability, and thus would not be eligible for the child credit. The EIC for this taxpayer would be $2,271, and thus the net Federal income tax liability would be -$2,271. If they were to marry, their regular Federal income tax liability would be $915, and thus they would be eligible for the full child credit of $800 for the two children. Additionally, they would receive an EIC of $1,284, for a net Federal income tax liability of -$1,169. The marriage penalty is thus -$1,169 - (-$1,993 + - $2,271) = $3,095.

7. The amount of the marriage penalty would have been even larger if each individual had two or more children.

8. In 1951, a separate rate schedule was created for unmarried heads of household with dependents ("head of household" status). Since the bracket breakpoints and standard deduction were more than half of those for joint returns, marriage penalties arose for some taxpayers eligible for filing as head of household.

9. *Lucas v. Earl*, 281 U.S. 111 (1930).

10. *Poe v. Seaborn*, 282 U.S. 101 (1930).

11. Since income splitting had been available in community property States prior to 1948, a marriage bonus had already existed in such States.

12. H.R. 2456, the "Marriage Tax Elimination Act," was introduced on September 11, 1997, by Mr. Weller and others.

13. An alternative would be to apply single rates or head of household rates, as appropriate. A number of issues would need to be addressed under this alternative, such as whether both spouses would be able to use head of household rates (if the couple have more than one child). The head of household rate structure is more favorable than that of the single rate structure. Thus, this alternative would have a greater revenue loss.

14. It is not clear whether ownership rights would be determined without regard to community property laws.

15. This proposal is similar to the two-earner deduction that was enacted in the Economic Recovery Tax Act of 1981. The deduction was repealed by the Tax Reform Act of 1986.

16. H.R. 2593, the "Marriage Penalty Relief Act," was introduced on October 1, 1997, by Mr. Herger and others.

17. Daniel R. Feenberg and Harvey S. Rosen, "Recent Developments in the Marriage Tax," *National Tax Journal*, 48, March 1995, pp. 91-102.

18. United States Congress, Congressional Budget Office, *For Better or For Worse: Marriage and the Federal Income Tax*, June 1997.

19. *Ibid*., p. 70.

20. See the Appendix for the mathematical derivation of this result.

21. Even if the bracket breakpoints and the standard deduction amounts for unmarried taxpayers (and for married taxpayers filing separate returns) were half of those for married couples filing a joint return, the current tax system would not be marriage neutral. Some married couples would still have marriage bonuses. As described below, the joint return in such a system would allow married couples to pay twice the tax of a single taxpayer having one-half the couple's taxable income. With progressive rates, this income splitting may result in reduced tax liabilities for some couples filing joint returns. For example, consider a married couple where one spouse has $60,000 of income and the other has none. By filing a joint return, the couple pays the same tax as a pair of unmarried individuals each with $30,000 of income. With progressive taxation, the tax liability on $30,000 would be less than half of the tax liability on $60,000. Thus the married couple has a marriage bonus: the joint return results in a smaller tax liability than the combined tax liability of the

spouses if they were not married.

22. In such a system, the refundability of the tax credit combined with an equal marginal tax rate on all income would make irrelevant any splitting of income between the individuals. Refundability of the tax credit also would create progressivity in what would otherwise be a proportional tax. Such a system could not have standard deductions. See footnote 6, above, for further explanation.

23. This discussion assumes that the dilemma cannot be resolved by moving to a proportional tax system.

24. For some recent articles calling into question the justification for joint returns and the assumption of pooling of income among members of a household, see Marjorie E. Kornhauser, "Love, Money, and the IRS: Family, Income Sharing, and the Joint Income Tax Return," 45 *Hastings Law Journal* 63 (1993); Edward J. McCaffery, "Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code," 40 *UCLA Law Rev*iew 983 (1993); and Lawrence Zelenak, "Marriage and the Income Tax," 67 *Southern California Law Review* 399 (1994).

25. As a single taxpayer, the man could claim the standard deduction of $4,250 and one personal exemption of $2,700 for 1998, effectively exempting the first $6,950 of his earnings. This example ignores payroll taxes.

26. See, Charles L. Ballard, John B. Shoven, and John Whalley, "General Equilibrium Computations of the Marginal Welfare Costs of Taxes in the United States," *American Economic Review*, 75, March 1985, for a review of econometric studies on labor supply of so-called primary and secondary earners. CBO, *For Better or Worse*, pp. 10-12, also reviews this literature.

27. The decision to work additional hours may be less sensitive to changes in the marginal tax rate than the decision to enter the labor force. See, Robert K. Triest, "The Effect of Income Taxation on Labor Supply in the United States," *The Journal of Human Resources*, 25, 1990.

28. For example, the Virginia State income tax allows separate reporting of income by married couples on a combined tax return, with separate allocations of personal exemptions and deductions as determined by the taxpayer.