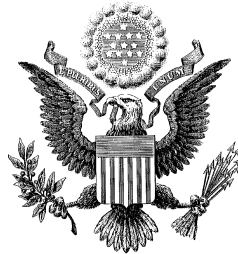


REDUCING MARRIAGE TAXES: ISSUES AND PROPOSALS

A JOINT ECONOMIC COMMITTEE STUDY



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**Joint Economic Committee
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Abstract

Marital status may affect a couple's federal income tax liability. Couples who pay more taxes when they are married than they would pay if they were single are said to incur "marriage penalties." Couples who pay less taxes as a consequence of marriage are said to receive "marriage bonuses." This paper discusses the sources of marriage taxes and their economic effects. It then examines some of the proposals that have been offered to reduce marriage penalties.

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REDUCING MARRIAGE TAXES: ISSUES AND PROPOSALS

EXECUTIVE SUMMARY

Marriage penalties and bonuses occur because several provisions in the tax code treat joint tax filers differently than two single filers with the same total income. Marriage taxes most commonly arise because of variations in the size of the standard deduction and the widths of the tax brackets across different filing statuses. At low levels of income, the earned income tax credit (EITC) is the main source of marriage taxes.

Whether a particular couple receives a marriage penalty or bonus (or neither) depends primarily on their division of income. Marriage penalties are more likely to occur if a couple's income is evenly divided between husband and wife. In contrast, marriage bonuses are more likely to occur if a couple's income is largely attributable to one spouse. For a given level of income, the largest penalties are generally paid by two-earner couples with a 50-50 income split, and the largest bonuses are received by one-earner couples (100-0 income split).

Economic Effects

Joint tax filing stacks the income of the secondary earner (the lesser earning spouse) on top of the primary earner's income. As a result the secondary earner's income is often taxed at a higher marginal tax rate relative to a system of individual filing. Joint tax filing can, therefore, reduce the after-tax income of secondary earners. The reduction in after-tax income may discourage secondary earners from entering the labor force or from working as many hours as they would otherwise choose. This bias disproportionately burdens married women because they are typically the secondary earners of their households.

The distortion in labor supply created by joint filing imposes economic costs on many households (in terms of foregone income) and on the economy (in terms of lost economic output). The estimated economic cost of taxing secondary earners at relatively higher marginal tax rates outweighs the associated increase in revenue.

Proposals to Reduce Marriage Penalties

During the past 25 years, there has been a growing trend toward more two-earner couples with greater income equality between spouses. This trend has increased the incidence and average size of marriage penalties. As a result, several proposals aimed at reducing marriage penalties have been introduced. All of the proposals would maintain marriage bonuses and none would eliminate all penalties for all couples. The three main proposals are outlined below.

Optional filing (H.R. 2456) would allow couples the option of filing jointly, as they do now, or filing as two singles on the same tax return. Thus, couples could choose the filing status that provides them with the lower tax liability. Optional filing would eliminate the penalties arising from the standard deduction and the widths of the tax brackets. The proposal would:

- eliminate most marriage penalties and maintain marriage bonuses.
- A reduced penalty could exist for couples with children, EITC-eligible couples, and middle- and high-income couples who are subject to the phase-out provisions of various tax breaks.
- The penalty for EITC-eligible couples would be reduced by a maximum of \$210.
- Only couples incurring marriage penalties would receive tax cuts, and the size of their tax cuts would equal the size of their penalties in most cases.
- Couples receiving bonuses under joint filing would not be affected.
- Among couples who opt for single filing, non-working spouses would be encouraged to enter the labor force, and some working spouses may be encouraged to work more hours.
- The proposal could increase compliance costs relative to current law.

Income splitting (H.R. 3104 and H.R. 3734) would effectively increase the standard deduction and the widths of the tax brackets for joint filers to twice the amounts applicable to single filers. The proposal would, therefore, eliminate the penalties arising from the standard deduction and the widths of the tax brackets. The proposal is similar to optional filing except it makes no distinction regarding the division of income between spouses. This benefit would provide married couples with the most favorable tax treatment by treating them like two singles with a 50-50 income split. Income splitting would:

- convert most marriage penalties into bonuses and increase the size of existing bonuses.
- A reduced penalty could exist for couples with children, EITC-eligible couples, and middle- and high-income couples who are subject to the phase-out provisions of various tax breaks.
- The penalty for EITC-eligible couples would be reduced by a maximum of \$210.
- Nearly all couples would receive tax cuts.
- Many non-working spouses would be encouraged to enter the labor force, and some working spouses may be encouraged to work more hours.
- The proposal could be perceived as a singles penalty because single taxpayers would have to bear a substantially larger share of the total tax burden even though their tax liabilities would remain the same.

The *second-earner deduction (H.R. 2593)* would allow couples with two-wage earners to deduct 10 percent of the income of the lower earning spouse up to a maximum deduction of \$3,000. Under the second-earner deduction:

- most marriage penalties would be reduced, and some would be eliminated or converted into bonuses. Marriage bonuses received by two-earner couples would be increased.
- One-earner couples would not be affected.
- The penalty for EITC-eligible couples would be reduced by a maximum of \$450.
- The deduction would reduce the tax liabilities of two-earner couples by a maximum of \$450 to \$1,188 depending on their tax brackets.
- Non-working spouses would be encouraged to enter the labor force. Working spouses who earn less than \$30,000 would be encouraged to work more hours.
- The proposal would reduce the marriage penalties that arise from income stacking, but it would not eliminate any of the structural penalties in the tax code.

REDUCING MARRIAGE TAXES: ISSUES AND PROPOSALS

Marital status may affect a couple's federal income tax liability. Couples who pay more taxes when they are married than they would pay if they were single are said to incur "marriage penalties." Couples who pay less taxes as a consequence of marriage are said to receive "marriage bonuses." This paper discusses the sources of marriage taxes and their economic effects. It then examines some of the proposals that have been offered to reduce marriage penalties.

SOURCES OF MARRIAGE TAXES

The federal income tax code treats married couples as a single economic unit by taxing their combined incomes on a joint return.¹ Marriage penalties and bonuses occur because many provisions in the tax code treat joint filers differently than two single filers with the same total income. The tax code contains 66 provisions that can affect a married couple's tax liability.²

Tax Rate Schedules

The two most common sources of marriage taxes are the standard deduction and the widths of the tax brackets. Figure 1 shows that the combined standard deduction for two individuals filing single returns is \$8,500, but the standard deduction for a married couple filing a joint return is only \$7,100. Thus, joint filing increases a couple's taxable income by \$1,400. Two single parents filing as heads of households would increase their taxable income by \$5,400 if they were to marry. (This provision does not affect couples who itemize.)

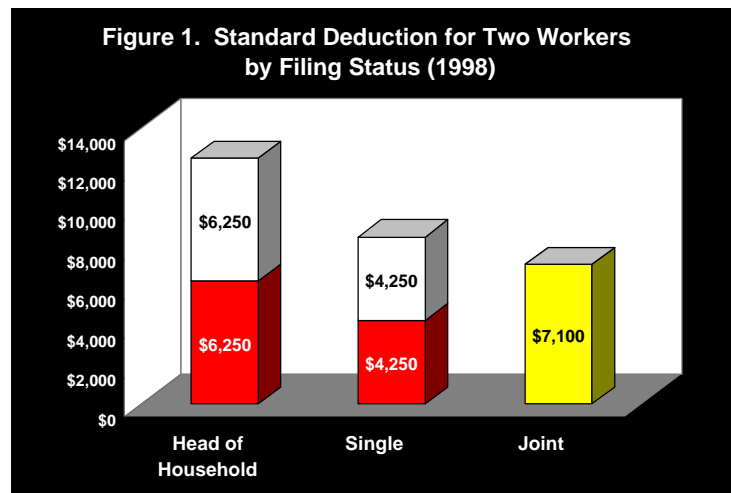


Table 1 below shows that the tax brackets for joint filers are not twice as wide as those for single filers or heads of households. As a result, more of a couple's combined income may be taxed at a higher marginal tax rate under joint filing, and in some cases, a couple's combined income may push them into a higher tax bracket.

¹ Spouses are allowed to file separately, but doing so usually results in a combined tax liability that is at least as great as their tax liability under joint filing.

² American Institute of Certified Public Accountants, "Marriage Penalty/Divorce/Domestic Relations Tax Issues," February 13, 1998.

Table 1. Federal Income Tax Brackets, 1998

Taxable Income			Marginal Tax Rate
Joint	Single	Head of Household	
\$0 – 42,350	\$0 – 25,350	\$0 – 33,950	15%
\$42,350 – 102,300	\$25,350 – 61,400	\$33,950 – 87,700	28%
\$102,300 – 155,950	\$61,400 – 128,100	\$87,700 – 142,000	31%
\$155,950 – 278,450	\$128,100 – 278,450	\$142,000 – 278,450	36%
\$278,450 +	\$278,450 +	\$278,450 +	39.6%

These features of the tax code can create marriage penalties or bonuses for a particular couple depending on the division of income between spouses. Examples are provided in Appendix 1.

The Earned Income Tax Credit (EITC)

At low levels of income, marriage taxes primarily arise because of the standard deduction and the EITC, a tax credit for low-income workers. Table 2 shows that three different EITC schedules exist for households with no children, households with one child, and households with two or more children. For each schedule, the size of the credit increases over a phase-in range of income up to a maximum amount; the maximum credit is awarded over a specified range of income; the size of the credit then decreases over a phase-out range of income until it reaches zero.

Table 2. EITC Schedules, 1998

	Maximum Credit	Income Phase-In Range	Maximum Credit Range	Income Phase- Out Range
No children	\$341	\$0 - 4,460	\$4,460 - 5,570	\$5,570 - 10,028
One child	\$2,271	\$0 - 6,680	\$6,680 - 12,260	\$12,260 - 26,470
Two or more children	\$3,756	\$0 - 9,390	\$9,390 - 12,260	\$12,260 - 30,095

The EITC can affect a couple's tax liability for at least two reasons. First, the size of the credit does not depend on a household's filing status. In other words, eligibility for the credit is the same for singles, heads of households, and married couples. Thus, combining two incomes on a joint return may push a couple into the phase-out range of the EITC and reduce the size of their credit. Second, the size of the credit does not increase for households with more than two children. Combining more than two children into one household may, therefore, result in a smaller tax credit. The size of the credit may also be reduced if two unmarried individuals each bring one child to a marriage. In this case, each child brings rise to a smaller credit because the maximum credit available to households with two children is less than twice the maximum credit available to households with one child.³

³ Joint Committee on Taxation, *Impact on Individuals and Families of Replacing the Federal Income Tax*, Joint Committee Print JCS-8-97 (Washington, DC: Government Printing Office) 1997, pp. 37-38.

These features of the EITC can create large marriage penalties or bonuses for low-income couples. An example of how the EITC creates marriage penalties is provided in Appendix 1.

Means-Tested Tax Provisions

Marriage taxes can also arise because of many provisions in the tax code that provide credits, deductions, and exemptions on the basis of income. In many cases, the income limit at which a tax break phases out for joint filers is not twice as high as the income limit applicable to single filers. In such cases, a couple's combined income may disqualify them from claiming a tax break that they are eligible for as singles.

For example, the child tax credit allows taxpayers to claim a \$400 tax credit in 1998 for each of their dependent children. The full credit is available to single tax filers with adjusted gross incomes (AGI) less than \$75,000 and to joint tax filers with AGI less than \$110,000. Consider two workers, each with one child and each earning \$65,000. If both workers were single, each could claim the maximum credit. However, if the workers were married to each other, they would be ineligible for the credit because their combined income of \$130,000 would exceed the income threshold for joint filers. The phase out of the credit would, therefore, create an \$800 marriage penalty for the couple.

Phase-out provisions can also create marriage bonuses in some cases. For instance, a worker earning \$80,000 would not qualify for the maximum child tax credit when single, but would qualify for it when married to a spouse who earns less than \$30,000.

Other means-tested provisions that may affect a couple's joint tax liability include the reduction of personal exemptions and itemized deductions at high levels of income, the taxation of Social Security benefits above certain levels of income, and the phase out of deductible contributions to Individual Retirement Accounts.

Division of Income

Whether a particular couple receives a marriage penalty or bonus (or neither) depends primarily on their division of income.⁴ Marriage penalties can only occur if both spouses have earned incomes. Couples with one earner almost never pay penalties and usually receive bonuses. In general, marriage penalties are more likely to occur if a couple's income is evenly divided between husband and wife, and marriage bonuses are more likely to occur if a couple's earnings are largely attributable to one spouse. For a given level of income, the largest penalties are usually paid by two-earner couples with a 50-50 income split, and the largest bonuses are usually received by one-earner couples (100-0 income split).

It is very difficult to quantify the average size of marriage taxes or the number of couples affected by them because many assumptions must be made about each couple's financial

⁴ Other factors such as level of income, number of children, and allowable deductions are also important.

characteristics. A recent study by the General Accounting Office (GAO) found that the current data was insufficient to make such an assessment.⁵

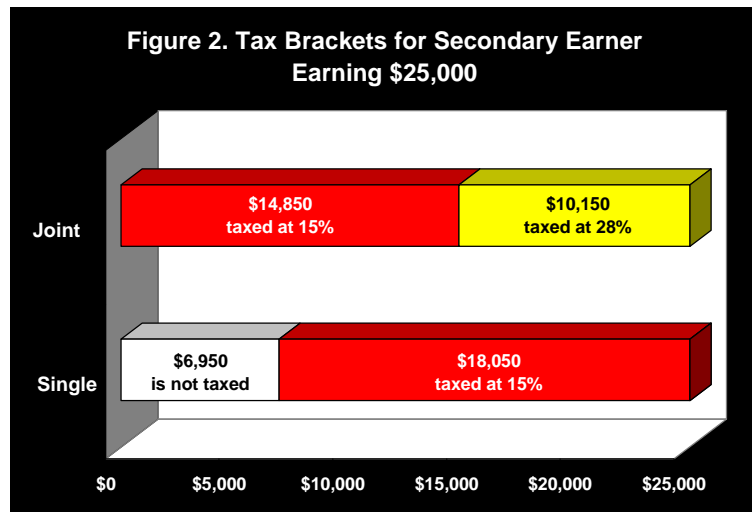
THE ECONOMIC EFFECTS OF JOINT TAX FILING

The Second-Earner Bias

Joint tax filing creates a “second-earner bias” in the federal income tax code. The bias occurs because the income of the secondary earner is stacked on top of the primary earner’s income. As a result, the secondary earner’s income may be taxed at a relatively higher marginal tax rate.

To elaborate, consider a married couple in which the husband works outside the home earning \$40,000 per year, and the wife is a homemaker who earns no taxable income. If the couple claims the standard deduction and two personal exemptions, their taxable income would be \$27,500, and they would fall in the 15 percent tax bracket. Their tax liability would reflect a marriage bonus of \$1,834. If the wife decides to enter the labor force earning \$25,000 per year, her income would be added to her husband’s income to yield a combined taxable income of \$52,500. The wife’s additional income would push the couple into the 28 percent tax bracket and create a marriage penalty of \$529.

Figure 2 shows that if the wife were allowed to file a single tax return, the first \$6,950 of her income would not be taxed, and the remaining \$18,050 would be taxed at 15 percent. However, under joint filing, the first \$14,850 of her income is taxed at 15 percent, and the remaining \$10,150 is taxed at 28 percent. Thus, joint filing reduces the wife’s after-tax income by \$2,362 relative to single filing.



Joint tax filing essentially treats the incomes of the primary and secondary earners differently. In this example, the primary earner enters the work force at a zero percent tax rate, and the last dollar of income he earns is taxed at 15 percent. The secondary earner enters the labor force at a 15 percent tax rate, and the last dollar of income she earns is taxed at 28 percent. Even if the wife’s income did not push the couple into a higher tax bracket, she still would be affected by the second-earner bias because she still could not take advantage of a zero tax bracket. Thus, more of her income would be taxed at a higher rate.

⁵ United States General Accounting Office, *Income Tax Treatment of Married and Single Individuals*, Report No. GAO/GGD-96-175, (Washington, DC: Government Printing Office) September 1996.

The second-earner bias is a consequence of joint tax filing and, therefore, affects all couples regardless of whether they incur marriage penalties or bonuses. However, the effect of the bias is more severe if the secondary earner's income creates a marriage penalty.

Effect on Labor Supply

Married women are typically the secondary earners of their households for at least two reasons. First, wives, on average, earn less than their husbands. Thus, their incomes are usually less essential to their families' economic well being. Second, married women tend to move in and out of the work force, between full-time and part-time jobs, depending on their families' needs.⁶ As a result, they are often less attached to the work force relative to their husbands. A great deal of research indicates that the labor supply of secondary earners is highly sensitive to marginal tax rates. Because married women are usually secondary earners, joint tax filing may distort their labor supply decisions.

Several studies have confirmed that married women are more responsive to high marginal tax rates relative to other demographic groups.⁷ One study by Barry Bosworth and Gary Burtless of the Brookings Institution estimates that female labor supply increased by an average of 61 hours per year between 1981 and 1989 in response to the marginal tax rate reductions of the 1980s.⁸ This gain represents a 5.4 percent increase above previous trends. The largest gains occurred among married women in high-income families.⁹

Another study by Nada Eissa of the University of California in Berkeley concludes that the labor supply of high-income married women "increased dramatically" in response to the marginal tax rate reductions of the Tax Reform Act (TRA) of 1986.¹⁰ Eissa estimates that a 10 percent increase in the after-tax wage increased the labor supply of high-income married women by approximately 8 percent. At least half of the increase is believed to represent labor force participation.

The research suggests that once married women enter the labor force, they are less likely to exit in response to work disincentives. In other words, high marginal tax rates may not induce women to leave the work force to the same extent that low marginal tax rates encourage them to enter. For married women already in the labor force, high marginal tax rates may have a larger impact on decisions regarding how many hours to work and the form in which compensation is taken (e.g., cash wages or non-taxable fringe benefits).

⁶ Howard V. Hayghe and Suzanne M. Bianchi, "Married Mothers' Work Patterns: the Job-Family Compromise," *Monthly Labor Review*, Vol. 117, June 1994, pp. 24-30.

⁷ See for example, Michael J. Boskin and Eytan Sheshinski, "Optimal Tax Treatment of the Family: Married Couples," *Journal of Public Economics*, Vol. 20, No. 3, 1983, pp. 281-287.

⁸ Barry Bosworth and Gary Burtless, "Effects of Tax Reform on Labor Supply, Investment, and Saving," *Journal of Economic Perspectives*, Vol. 6, No. 1, Winter 1992, pp. 3-25.

⁹ High-income households experienced the largest reductions in marginal tax rates during the 1980s.

¹⁰ Nada Eissa, "Taxation and the Labor Supply of Married Women: The Tax Reform Act of 1986 as a Natural Experiment," National Bureau of Economic Research Working Paper No. 5023, February 1995.

The distortions in labor supply created by the second-earner bias may impose considerable costs on the economy in terms of lost economic output and reduced efficiency. Estimates indicate that the economic cost of taxing wives at relatively higher marginal tax rates outweighs the associated increase in revenue.¹¹ An optimal tax system should, therefore, tax the secondary earner at a relatively lower marginal tax rate in order to maximize economic efficiency.¹²

HISTORY OF MARRIAGE TAXES¹³

When the individual income tax was established in 1913, all individuals filed their taxes separately under an individual tax schedule. As a result, the tax code was marriage neutral—individuals paid the same income tax whether they were single or married. Because the tax code was also progressive, one-earner couples often paid higher taxes than two-earner couples with identical incomes. For instance, a couple with one wage earner making \$100,000 per year was taxed at a higher rate than a couple with two wage earners making \$50,000 each.

Couples with the same incomes could also pay different taxes depending on their state of residence. States with community property laws allowed couples to split their incomes evenly between two tax returns regardless of who actually earned the income. The benefit of income splitting lowered the tax liabilities of married couples in community property states. In contrast, couples residing in common law states were not allowed to split their incomes for tax purposes and often paid higher taxes.

As the size and scope of federal income taxation grew during World War II, Congress set out to equalize the treatment of similarly situated married couples. In 1948, Congress established joint filing, thus extending the benefit of income splitting to all married couples regardless of their state of residence. The 1948 law effectively created marriage bonuses for the majority of couples.

The 1948 law was perceived by many as a singles penalty because single workers paid substantially higher taxes than one-earner couples with the same incomes. In 1969, Congress responded to the concerns of single workers by narrowing the tax brackets for joint filers, thus reducing the discrepancy in tax liabilities between singles and their married counterparts. The narrowing of the tax brackets created the marriage penalty that exists in today's laws. The creation of the EITC in 1975 increased marriage penalties for some low-income couples who reduced their EITC eligibility by marrying.

As more women entered the work force during the 1970s, more couples were subject to the marriage penalty and opposition to the 1969 tax changes grew. Congress responded by including a provision in the Economic Recovery Tax Act (ERTA) of 1981 that granted two-earner couples a

¹¹ Martin Feldstein and Daniel Feenberg, "The Taxation of Two-Earner Families," National Bureau of Economic Research Working Paper No. 5155, June 1995.

¹² *Op. Cit.*, Bosworth and Sheshinski

¹³ Historical discussion draws from Gregg A. Esenwein, "The Federal Income Tax and Marriage Neutrality," Congressional Research Service, January 31, 1997; and Edward McCaffery, *Taxing Women*, (Chicago: University of Chicago Press) 1997.

tax deduction of up to \$3,000. The deduction reduced the size of the marriage penalty for most couples incurring a penalty and entirely eliminated it for some. The deduction also increased the marriage bonuses received by many two-earner couples.

Five years later, the second-earner deduction was repealed in TRA 1986 and replaced with broad-based tax reform. The standard deduction for married couples was increased, and the 14 bracket tax schedule was reduced to only two tax brackets. In addition, the maximum marginal tax rate on income was lowered from 50 percent to 28 percent. TRA 1986 sharply reduced or eliminated the marriage penalty for the majority of two-earner couples. The law also reduced the severity of the second-earner bias because the flatter tax code allowed fewer opportunities to be pushed into a higher tax bracket.

The Omnibus Budget Reconciliation Act (OBRA) of 1990 created a third marginal income tax rate of 31 percent, thus slightly increasing the size of marriage taxes for high-income couples. Two years later, OBRA 1993 added two more tax brackets of 36 and 39.6 percent to the tax schedule. OBRA 1993 also expanded the size and coverage of the EITC. Together, these changes significantly increased marriage taxes for couples at the low and high ends of the income scale.

In 1995, Congress once again tried to grant tax relief to two-income families. The U.S. Senate considered a proposal to increase the standard deduction for joint filers to twice that of single filers; and the U.S. House of Representatives passed a bill that would have provided a tax credit to any couple who paid a marriage penalty. The Senate proposal was included in the Balanced Budget Act of 1995, but the entire bill was vetoed by President Clinton.

Trends among Married Couples

The federal income tax code was largely structured when one-earner couples represented the traditional family, and earnings equality between husbands and wives was rare. Thus, the large majority of married couples benefited from marriage bonuses, and relatively few were affected by the creation of marriage penalties in 1969. However, changes in social attitudes, demographic patterns, and labor markets have contributed to a growth in marriage penalties.

For instance, the labor force participation rate of married women increased by 49 percent between 1970 and 1996, from 41 to 61 percent.¹⁴ This increase led to a rise in the proportion of two-earner couples. Between 1970 and 1996, the proportion of married couple families with both spouses in the work force increased by nearly one-third, from 46 to 60 percent, and the proportion with only one spouse in the work force fell by almost 40 percent, from 36 to 22 percent.¹⁵

Moreover, married women's median income increased by 42 percent between 1974 and 1996, after adjusting for inflation. However, the median income of married men fell by approximately 4 percent over the same time period.¹⁶ The relative increase in married women's incomes has led to greater earnings equality between husbands and wives. The proportion of working-aged married

¹⁴ U.S. Bureau of the Census, Internet, *Statistical Abstract of the United States 1997*, Table No. 631.

¹⁵ U.S. Bureau of Labor Statistics, unpublished data.

¹⁶ U.S. Bureau of the Census, Internet, *Current Population Survey (CPS): 1947-1996*, Table P-7.

couples in which each spouse earned at least one-third of the couple's income doubled between 1969 and 1995, from 17 to 34 percent.¹⁷

The trend toward more two-earner couples with greater income equality means that more married couples are potentially subject to larger penalties. As a result, several proposals to reduce or eliminate the burden on two-earner couples have been introduced.

REDUCING MARRIAGE PENALTIES

Changes in the tax laws relating to married couples have tried to balance three different principles of tax equity:

- the principle of *horizontal equity* requires couples with the same ability to pay taxes to incur the same tax liabilities;
- the principle of *marriage neutrality* requires a couple's tax liability to be the same whether they are married or single; and
- the principle of *progressivity* requires tax liability to increase as a percentage of income as income rises.

A tax system can achieve any two of these principles simultaneously, but it cannot achieve all three. The existing tax code achieves the principles of horizontal equity and progressivity, but it is not marriage neutral.

The inconsistency among the three goals of tax equity poses a difficult problem for policy makers seeking to reduce or eliminate the marriage penalty. Any proposal to alleviate the burden will necessarily entail trade-offs between different groups of taxpayers and different goals of tax policy. As a result, subjective decisions must be made regarding the proper unit of taxation, the appropriate measure of a household's ability to pay, the equitable treatment of married versus single taxpayers, and the extent to which the tax code should promote social policy goals at the expense of economic efficiency.

The Proposals

Several proposals to reduce the marriage penalty have been introduced by Members of Congress. All of the proposals would maintain marriage bonuses and none would eliminate all marriage penalties for all couples. (Marriage neutrality can only be achieved by reverting to a system of individual filing or through fundamental tax reform.) Although, the effect of any proposal depends on how revenue losses would be offset, some observations can be made about the different proposals. A summary of the proposals is provided in Table 3 at the end of this section.

¹⁷ Congressional Budget Office (CBO), "For Better or for Worse: Marriage and the Federal Income Tax," (Washington, DC: Government Printing Office) June 1997, p. 38.

Optional Filing Status

The Marriage Tax Elimination Act (H.R. 2456), introduced by Congressmen Jerry Weller (R-IL) and David McIntosh (R-IN), would allow couples the option of filing jointly, as they do now, or filing as two singles on the same tax return.¹⁸ Thus, couples could choose the filing status that provides them with the lower tax liability. The Joint Committee on Taxation (JCT) estimates that optional filing would reduce federal government revenue by \$101 billion over five years. The legislation has been cosponsored by 236 Members in the House.

Optional filing would eliminate most marriage penalties and maintain marriage bonuses. Thus, the tax code would be marriage neutral for couples who choose to file as singles, and it would favor marriage for most other couples.

The proposal would eliminate penalties arising from the standard deduction and the widths of the tax brackets. A reduced penalty could exist for couples with children. If single, these couples could take advantage of the relatively wider tax brackets and higher standard deduction under the head of household filing status. The head of household tax schedule would not be available to married couples under the optional filing proposal.

In addition, a reduced penalty could exist for EITC-eligible couples because eligibility for the EITC would be based on joint income regardless of which tax schedule a couple chooses to use. If EITC eligibility were based on individual income, then low-income spouses would qualify for the EITC even if they were married to wealthy spouses. This would result in a redistribution of income from low- and middle-income households to high-income households. Under optional filing, the marriage penalty for EITC-eligible couples would be reduced by a maximum of \$210 (reflecting the reduced penalty in the standard deduction).

Finally, a reduced penalty could exist for middle- and high-income couples because eligibility for various tax breaks would be based on joint income. As a result, the penalties arising from the phase-out provisions of the tax code would remain because a couple's combined income could push them beyond the phase-out threshold of a particular tax break.¹⁹

Optional filing would only lower the tax liabilities of couples who incur marriage penalties under joint filing. The size of a couple's tax cut would equal the size of their marriage penalty (except for the exceptions noted above in which the penalty is not eliminated). Thus, for a given level of income, couples with roughly equal incomes would receive the largest tax cuts because they generally pay the largest penalties. Couples who receive marriage bonuses under current law would not be affected by the proposal—their tax liabilities would remain the same. Examples illustrating the effect of optional filing on various couples are contained in Appendix 2.

Allowing couples to choose their filing status means that couples with equal incomes may not pay the same income tax. Some observers argue that ending horizontal equity would be unfair

¹⁸ Similar bills have been introduced by John Kasich, R-OH (H.R. 2462); Sheila Jackson-Lee, D-TX (H.R. 3059); and Kay Bailey Hutchison, R-TX (S. 1314).

¹⁹ Optional filing eliminates the penalty arising from the limitation of itemized deductions and personal exemptions.

because couples with the same total income are equally well off and, therefore, should incur the same tax liability. Others believe that income alone is not a good measure of a couple's economic well being.²⁰ For instance, two couples may not be equally well off if the earners in the first couple work 40 hours a week at a higher wage, and the earners in the second couple earn the same total income by working a greater number of hours at a lower wage. Thus, requiring couples with equal incomes to pay the same income tax may not necessarily satisfy the goal of horizontal equity.

Opponents of optional filing note that the proposal would increase compliance costs relative to current law. Couples would have to calculate their taxes jointly and individually to determine which provides them with the lower tax liability. Furthermore, specific rules would have to be made regarding the division of deductions for couples who choose to file individually.

Income Splitting

Two separate bills would eliminate most marriage penalties by reinstating income splitting. Although the two bills would be implemented differently, both would have the same effect on couples' tax liabilities. The first bill, titled the Marriage Protection and Fairness Act (H.R. 3104), was introduced by Congressmen Bob Riley (R-AL) and Matt Salmon (R-AZ).²¹ The bill would allow each spouse to apply the single tax rate schedule to half of the couple's taxable income. The standard deduction used to determine taxable income would be increased to twice the standard deduction for single returns. The JCT estimates that the proposal would reduce federal government revenue by \$153 billion over five years. The legislation has been cosponsored by 83 Members in the House.

The second bill, titled the Marriage Tax Penalty Elimination Act of 1998 (H.R. 3734), was introduced by Congressmen Jerry Weller, David McIntosh, Bob Riley, and Wally Herger (R-CA).²² (This bill represents a collaborative effort by the primary sponsors of the three major marriage penalty bills to support a single piece of legislation.) The proposal would increase the standard deduction and the widths of the tax brackets for joint filers to twice the applicable amounts for single filers. Revenue estimates are not yet available, but should be similar to those of H.R. 3104. The legislation has been cosponsored by 45 Members in the House.

Income splitting proposals are similar to optional filing because they adjust for differences in the tax schedules between single and joint filers. However, the proposals differ from optional filing because they make no distinction regarding the division of income between spouses. In other words, couples are treated as if each spouse earns half of their total income regardless of which spouse actually generates that income. Income splitting would, therefore, provide all couples with the most favorable tax treatment by effectively treating them like two singles with a 50-50 income split. This favorable treatment would reduce taxes for nearly all married couples. Couples with equal incomes would receive equal tax cuts, thus maintaining horizontal equity.

²⁰ *Op. Cit.*, CBO, p. 9.

²¹ A similar bill was introduced in the Senate by Lauch Faircloth, R-NC (S. 1285).

²² A similar bill was introduced in the Senate by Kay Bailey Hutchison (S. 1999).

Moreover, income splitting would create marriage bonuses for most couples and increase bonuses for couples already receiving them, including one-earner couples. Thus, the proposals reduce marriage neutrality by heavily favoring marriage. Examples illustrating the effect of income splitting on various couples are contained in Appendix 2.

As with optional filing, income splitting would only eliminate penalties arising from the standard deduction and the widths of the tax brackets. A reduced penalty could exist for couples with children (who would otherwise file as heads of households if they were single), couples eligible for the EITC, and couples subject to the various phase-out provisions of the tax code.

Opponents contend that income splitting has two primary disadvantages. First, some analysts argue that the proposals inefficiently use scarce fiscal resources because a portion of the large revenue loss would finance bigger bonuses for couples who already receive them. Second, the establishment of income splitting in 1948 was perceived as a singles penalty because single taxpayers paid substantially higher income taxes than one-earner couples with the same total incomes. Complaints from single taxpayers led to the creation of the marriage penalty in 1969. A return to income splitting may bring about the same perceived inequities for single taxpayers who would have to bear a substantially larger share of the total tax burden (although their tax liabilities would remain the same).

Second-Earner Deduction

The Marriage Penalty Relief Act (H.R. 2593), introduced by Congressman Wally Herger and Congresswoman Barbara Kennelly (D-CT), would revive the second-earner deduction that was in the law between 1981 and 1986. Under this proposal, couples with two earners could deduct 10 percent of the income of the lesser earning spouse up to a maximum deduction of \$3,000. The deduction would be available to couples whether they itemize or claim the standard deduction. The JCT estimates that the second-earner deduction would reduce federal government revenue by \$45 billion over five years. The legislation has been cosponsored by 182 Members in the House.

Under the second-earner deduction, most couples incurring marriage penalties under current law would have their penalties reduced; some would have their penalties eliminated or converted into bonuses. Two-earner couples receiving bonuses under current law would receive larger bonuses. Thus, the proposal increases marriage neutrality for some couples and reduces it for others. One-earner couples would not be affected by the proposal and would continue receiving bonuses.

As with the other proposals, the second-earner deduction does not address the structural penalty in the EITC. However, it would reduce penalties for some EITC-eligible couples by reducing the income stacking problem that can potentially push a low-income couple into the 15 percent tax bracket. For instance, two single parents, each with one child and each earning \$10,000, would not pay any federal income tax. However, if they married each other, their combined income would push them into the 15 percent tax bracket and generate a \$315 federal income tax liability under current law. If they were allowed to deduct \$1,000, their tax liability would fall to \$165, thus reducing their marriage penalty by \$150. The proposal could reduce marriage penalties for some EITC-eligible couples by a maximum of \$450 (reflecting the value of a \$3,000 deduction at 15 percent).

A \$3,000 deduction would reduce the income tax liability of a two-earner couple by a maximum of \$450 to \$1,188 depending on their tax bracket. Thus, the dollar value of the deduction would be more valuable at high levels of income, but this may be appropriate because the dollar value of marriage penalties increases substantially with income. The proposal would not affect the tax liabilities of one-earner couples. Examples illustrating the effect of the second-earner deduction on various couples are contained in Appendix 2.

Under a second-earner deduction, two-earner couples would pay less taxes than one-earner couples with the same total incomes. Some observers argue that this would penalize one-earner couples by increasing their share of the total tax burden (although their tax liabilities would remain the same). Others believe that two-earner couples are not as well off as one-earner couples with the same total incomes. For instance, a one-earner couple benefits from the non-earning spouse's work inside the home, the value of which is not taxed. The homemaker's non-taxed services increase the couple's economic well being. In contrast, a couple with two wage earners might have to pay for the services that a stay-at-home spouse provides, thus reducing their economic well being. In this respect, the two-earner couple is worse off and should pay less income tax.

Opponents of the proposal point to two disadvantages. First, the deduction would not eliminate any of the structural penalties in the tax code—it would merely reduce them. Second, part of the revenue loss would finance larger bonuses for couples who already receive them.

Other Proposals

Several other bills aimed at providing broad-based tax relief would also reduce the size of the marriage penalty. Some of these proposals are briefly summarized below.

- H.R. 1584 (Sam Johnson, R-TX) includes a provision that would allow couples affected by marriage penalties to claim a tax credit of up to \$145 against their tax liabilities.
- H.R. 2718 (Joe Knollenberg, R-MI) would reduce marriage penalties by increasing the standard deduction for joint filers to twice that of single filers. The bill would also lower marginal tax rates for all taxpayers from 15, 28, 31, 36, and 39.6 percent to 14.25, 26.6, 29.45, 34.2, and 37.62 percent, respectively. Lowering the marginal tax rates would reduce the size of marriage penalties relative to current law by reducing the tax associated with being pushed into a higher tax bracket.
- H.R. 3151 (John Thune, R-SD) and H.R. 3175 (William “Mac” Thornberry, R-TX) would expand the 15 percent tax bracket. This would provide less opportunity for a secondary earner's income to push a couple into the 28 percent tax bracket, thus reducing marriage penalties for millions of middle-income couples. The proposal would also reduce marriage penalties at higher levels of income relative to current law because more income would be taxed at the 15 percent tax rate.

Table 3. Summary of the Marriage Penalty Proposals					
<i>Effect on:</i>					
		<i>Two-earner couples with penalties</i>	<i>Two-earner couples with bonuses</i>	<i>One-earner couples with bonuses</i>	<i>EITC-eligible couples</i>
Optional Filing	<i>Marriage tax</i>	Reduced or eliminated	No effect	No effect	Penalty reduced by maximum of \$210
	<i>Tax liability</i>	Reduced	No effect	No effect	Sometimes reduced
Income Splitting	<i>Marriage tax</i>	Reduced, eliminated, or converted to bonuses	Bonuses increased	Bonuses increased	Penalty reduced by maximum of \$210
	<i>Tax liability</i>	Reduced	Reduced	Reduced	Sometimes reduced
Second-Earner Deduction	<i>Marriage tax</i>	Reduced, eliminated, or converted to bonuses	Bonuses increased	No effect	Penalty reduced by maximum of \$450
	<i>Tax liability</i>	Reduced	Reduced	No effect	Sometimes reduced

Table 3 (cont'd.)						
	<i>Relative effect on goals of tax policy:</i>			<i>Structural penalties eliminated</i>	<i>Relative complexity</i>	<i>5-Year revenue loss (billions)</i>
	<i>Marriage neutrality</i>	<i>Horizontal equity</i>	<i>Progressivity</i>			
Optional Filing	Increased	Decreased	Maintained	Standard deduction and widths of tax brackets	High	\$101
Income Splitting	Decreased	Maintained	Maintained	Standard deduction and widths of tax brackets	Low	\$153 (H.R. 3104)
Second-Earner Deduction	No net effect	Decreased	Maintained	No structural penalties eliminated, only reduced	Low	\$45

EFFECT ON LABOR SUPPLY OF SECONDARY EARNERS

Eliminating or reducing marriage penalties is likely to increase the labor supply of married women by reducing the second-earner bias. One study estimates that if marriage penalties were eliminated after the 1986 tax reforms (when penalties were less severe than they are today), the labor supply of married women would have increased by an average of 46 hours per year.²³ The effect would have been greater among married women from high-income families and married women who earned substantially less than their husbands.

Reducing marriage taxes will affect two different aspects of the labor supply decision. First, it will affect the decision of a non-working spouse to enter the labor force. Any proposal that reduces a secondary earner's *average* tax rate²⁴ relative to current law will increase his or her after-tax income. This incentive will encourage a non-working spouse to enter the labor force. Second, reducing marriage taxes will affect the decision of a working spouse to work more hours. Any proposal that reduces a secondary earner's *marginal* tax rate²⁵ relative to current law will increase the return to extra work. This incentive will encourage a working spouse to work more hours. The various proposals discussed above will either enhance the labor supply incentives of secondary earners or leave them unaffected. Table 6 at the end of this section summarizes the effect of the different proposals on the labor supply of secondary earners.

Optional Filing

Labor Force Participation

If a homemaker's decision to enter the labor force creates a marriage penalty under joint filing, the couple would choose to file as singles under the optional filing proposal. Single filing eliminates the second-earner bias because the income of the secondary earner is taxed separately. Thus, the non-working spouse enters the labor force at a zero tax rate instead of entering at the primary earner's higher marginal tax rate. The elimination of the second-earner bias lowers the secondary earner's average tax rate relative to current law and increases his or her after-tax income. This incentive will always encourage a non-working spouse to enter the labor force *if the couple opts for single filing*.

However, if the non-working spouse is deciding to enter the labor force at an income that is substantially lower than the primary earner's income, then the couple would likely receive a marriage bonus under joint filing. In this case, the couple would not choose to file individually because doing so would increase their combined tax liability. Thus, optional filing would not affect the labor supply decisions of the non-working spouse.

²³ Deenie Kinder Neff, "Married Women's Labor Supply and the Marriage Penalty," *Public Finance Quarterly*, Vol. 18, No. 4, October 1990, pp. 420-32.

²⁴ The average tax rate is defined as tax liability divided by income.

²⁵ The marginal tax rate is defined as the tax rate imposed on an additional dollar of income earned.

Number of Hours Worked

For second-earner spouses already in the work force, optional filing may encourage more work effort in some cases. Individual filing will either lower the marginal tax rate of the secondary earner or leave it unchanged (it will never increase the secondary earner’s marginal tax rate). If the marginal tax rate falls, then an additional dollar of income earned will be taxed at a lower rate. This incentive will encourage the lesser earning spouse to work more hours. If the marginal tax rate remains unchanged, optional filing will not generate any additional benefits at the margin and, therefore, will not affect the labor supply decisions of the secondary earner.

Table 4 provides two examples to illustrate how optional filing might affect a working spouse’s decision to work more hours. In the first example, the primary earner earns \$75,000 and the secondary earner earns \$25,000. Joint tax filing results in a marriage penalty of \$329. Thus, the couple chooses to file as singles. Single filing reduces the secondary earner’s marginal tax rate from 28 percent to 15 percent. In other words, out of an additional dollar of income earned, the secondary earner keeps 72 cents under joint filing and 85 cents under single filing. The reduction in the secondary earner’s marginal tax rate increases the value of his or her work at the margin and encourages him or her to work more hours. Hence, optional filing enhances the secondary earner’s labor supply incentive relative to current law.²⁶

Table 4. Effect of Optional Filing on Number of Hours Worked

Income of primary earner	\$75,000		\$60,000	
Income of secondary earner	\$25,000		\$40,000	
	Joint filing	Single filing	Joint filing	Single filing
Penalty/(bonus)	\$329	\$0	\$1,477	\$0
Second earner’s marginal tax rate	28%	15%	28%	28%

Note: (1) Assumes the standard deduction and two personal exemptions. (2) Marginal tax rates do not include payroll, state or local taxes.

Source: Joint Economic Committee calculations

In the second example, the primary earner earns \$60,000 and the secondary earners earns \$40,000. Once again, the couple can lower their tax liability by filing as singles. However, in this example, using the single tax rate schedule does not lower the secondary earner’s marginal tax rate. Thus, there is no additional benefit to working more hours. As a result, optional filing does not enhance the secondary earner’s labor supply incentives even though the couple opts for single filing.

²⁶ Although the secondary earner’s marginal tax rate may fall under single filing, the primary earner’s marginal tax rate may increase, thus discouraging work effort by the primary earner. Thus, the net effect on labor supply for the couple is ambiguous in some cases. However, many studies have found that the labor supply of secondary earners is more responsive to marginal tax rates than the labor supply of primary earners. If this is the case, single filing should result in a net increase in total hours worked by the couple.

Overall, optional filing would affect secondary earners differently depending on each couple's income and division of income. In general, optional filing always encourages a non-working spouse to enter the labor force *if the couple opts for individual filing*. Among working spouses, optional filing encourages a secondary earner to work more hours *if the couple opts for individual filing and if individual filing lowers the secondary earner's marginal tax rate*. The proposal is more likely to increase the number of hours worked by secondary earners in high-income households. It is less likely to increase labor supply among secondary earners in low- and middle-income households unless the couple's combined taxable income is grouped around the marginal tax-rate breakpoints.

According to many analysts, allowing couples to file as singles would be economically more efficient than the current system of joint filing because it would reduce distortions in labor supply that impose economic costs on households (in terms of foregone income) and on the economy (in terms of foregone output).

Income Splitting

Labor Force Participation

Under the income splitting proposals, the higher standard deduction and wider tax brackets allow more of the secondary earner's income to be taxed at a lower rate. This will often (but not always) reduce a secondary earner's average tax rate relative to current law and increase his or her after-tax income. This incentive will encourage many non-working spouses to enter the labor force. Hence, the effect of income splitting is similar to that of optional filing: it will either encourage labor force participation by non-working spouses, or it will have no effect on the incentive to enter the labor force.

Table 5 below provides two examples to illustrate how income splitting might affect a homemaker's decision to enter the labor force. In the first example, the primary earner earns \$40,000 per year and the non-working spouse is deciding whether to accept a job at \$20,000 per year. Under current law, the secondary earner's new income generates a tax liability of \$3,670. Thus, his or her average tax rate is 18 percent. Under income splitting, the secondary earner's income generates a tax liability of only \$3,000. Thus, income splitting lowers the average tax rate

Table 5. Effect of Income Splitting on Labor Force Participation

	Current law	Income splitting	Current law	Income splitting
Income of primary earner	\$40,000		\$40,000	
Income of secondary earner	\$20,000		\$10,000	
Second earner's tax liability	\$3,670	\$3,000	\$1,500	\$1,500
Second earner's average tax rate	18%	15%	15%	15%
Second earner's after-tax income	\$16,330	\$17,000	\$8,500	\$8,500

Note: (1) Assumes the standard deduction and two personal exemptions. (2) Average tax rates do not include payroll, state or local taxes.

Source: Joint Economic Committee calculations

to 15 percent and increases after-tax income by \$670. This incentive encourages the non-working spouse to enter the labor force. Hence, income splitting enhances the incentive to enter the labor force relative to current law.

In the second example, the non-working spouse is deciding whether to accept a job at \$10,000 per year. In this case, income splitting does not affect the secondary earner's average tax rate. All of the secondary earner's income is taxed at 15 percent under either provision. Hence, income splitting does not affect the non-working spouse's decision to enter the labor force.^{27, 28}

Although income splitting and optional filing have very similar effects on labor force participation, it is difficult to determine which proposal would encourage more working spouses to enter the labor force. Optional filing always encourages entry if a couple chooses to file individually, but not all couples will choose to file individually. Income splitting will encourage entry in many cases, but not all. Thus, it is difficult to determine which proposal would have the greater effect on the labor force participation of secondary earners.

Number of Hours Worked

The wider tax brackets and higher standard deduction under income splitting make it more difficult for a secondary earner's income to push the couple into a higher tax bracket. Thus, the proposals will reduce the secondary earner's marginal tax rate in some cases. This incentive will increase the return to working an additional hour and will encourage secondary earners to increase their labor supply. As with optional filing, income splitting is more likely to reduce marginal tax rates among secondary earners in high-income households. It is less likely to reduce marginal tax rates among secondary earners in low- and middle-income households unless the couple's taxable income is grouped around the marginal tax rate breakpoints.

Both of the income splitting proposals would be economically more efficient relative to current law because they would reduce distortions in labor supply created by the second-earner bias. The enhanced work incentives created by income splitting would reduce the economic costs imposed on households and the economy. (H.R. 3104 may be more efficient than H.R. 3734 because it imposes the same marginal tax rate on primary and secondary earners. In contrast, H.R. 3734 can impose a relatively higher marginal tax on secondary earners. As noted earlier, an optimal tax system would impose a lower marginal tax rate on secondary earners because they are relatively more sensitive to labor supply incentives.)

²⁷ Income splitting almost always reduces a couple's average tax rate regardless of whether a second earner enters the work force. Thus, the couple receives a tax cut (or an increase in after-tax income) even if labor supply does not increase. As a result, the primary earner can work less and maintain the same standard of living. However, income splitting may also lower the primary earner's marginal tax rate, thus encouraging more work effort. Hence, the net effect on the couple's labor supply is ambiguous when the second earner does not increase his or her labor supply.

²⁸ Although the effect of the two income-splitting proposals on tax liabilities is the same, each proposal is implemented differently. As a result, they may have slightly different effects on labor supply incentives. For instance, H.R. 3104 can reduce the income stacking problem to a greater extent than H.R. 3734. Hence, H.R. 3104 can reduce secondary earners' average tax rates to a relatively greater extent in some cases and generate stronger work incentives.

Second-Earner Deduction

The second-earner deduction permits the lesser earning spouse to deduct 10 percent of the first \$30,000 of income, thus lowering the couple's taxable income by a maximum of \$3,000. The deduction, therefore, reduces the marginal tax rate on the first \$30,000 of income earned by the secondary earner. Hence, the proposal is likely to increase labor supply among second-earner spouses who earn less than \$30,000 per year.

For instance, consider a couple in which one spouse earns \$30,000 per year, and the other is a homemaker who is deciding whether to enter the labor force at \$20,000 per year. Under current law, the \$20,000 of income generates a tax liability of \$3,000. If a 10 percent deduction is allowed, the secondary earner can deduct \$2,000 of income from taxation, thus increasing his/her after-tax income by \$300. The increase in after-tax income encourages the homemaker to enter the labor force. Moreover, each additional dollar of income earned will give rise to a 10 cent deduction. Thus, the secondary earner will continue to receive an additional benefit from working more hours until his or her income reaches \$30,000. However, a working spouse who earns more than \$30,000 does not derive any additional benefit from working more hours and, therefore, is not affected by the deduction.

Table 6. Effect of Proposals on Labor Supply of Secondary Earners

		<i>For couples receiving:</i>		<i>Effect on</i>	<i>Economic</i>
		<i>Penalties</i>	<i>Bonuses</i>	<i>second-earner</i>	<i>efficiency</i>
				<i>bias</i>	
Optional Filing	<i>Participation</i>	Increases	No effect	Eliminates for couples who file individually	More efficient
	<i>Hours worked</i>	Increases or no effect	No effect		
Income Splitting	<i>Participation</i>	Increases or no effect	Increases or no effect	Reduces	More efficient
	<i>Hours worked</i>	Increases or no effect	Increases or no effect		
Second-Earner Deduction	<i>Participation</i>	Increases	Increases	Reduces	Slightly more efficient
	<i>Hours worked</i>	Increases for spouses earning less than \$30,000	Increases for spouses earning less than \$30,000		

CONCLUSION

All of the marriage penalty proposals currently under consideration would maintain marriage bonuses, and none would eliminate all marriage penalties for all couples. In particular, penalties would remain for couples with children, low-income couples eligible for the EITC, and middle- and high-income couples subject to the various phase-out provisions of the tax code.

Moreover, the various proposals would affect couples differently depending on their level and division of incomes. In general, optional filing would be most favorable to couples with roughly equal incomes. At each level of income, these couples currently receive the largest marriage penalties and, therefore, would receive the largest tax cuts if they were permitted to file as singles. In contrast, income splitting would provide the greatest benefit to one-earner couples, who would have their marriage bonuses increased.

All of the proposals would be economically more efficient relative to current law because they would reduce the second-earner bias that exists under joint filing. As a result, many non-working spouses would be encouraged to enter the labor force, and many working spouses would be encouraged to work more hours. The increase in labor supply among secondary earners would reduce the economic costs imposed on households (in terms of foregone income) and on the economy (in terms of lost output). The various proposals would affect labor supply differently depending on each couple's income and income split. In general, optional filing and income splitting would enhance work incentives to the greatest extent; the second-earner deduction would have the smallest effect on labor supply. All of the proposals would likely affect labor force participation to a greater degree than hours worked.

Shahira E. Knight
Economist

APPENDIX 1

EXAMPLES OF MARRIAGE PENALTIES AND BONUSES

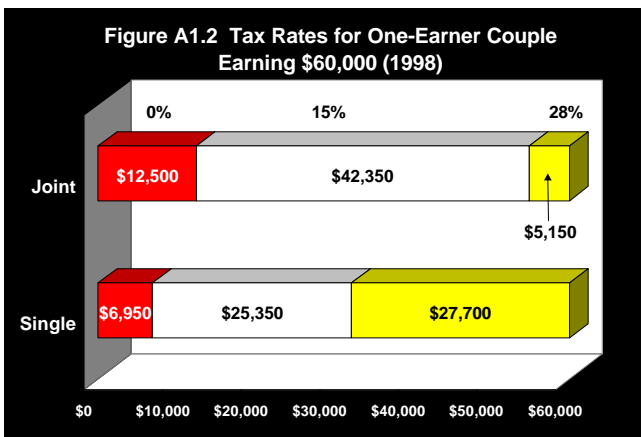
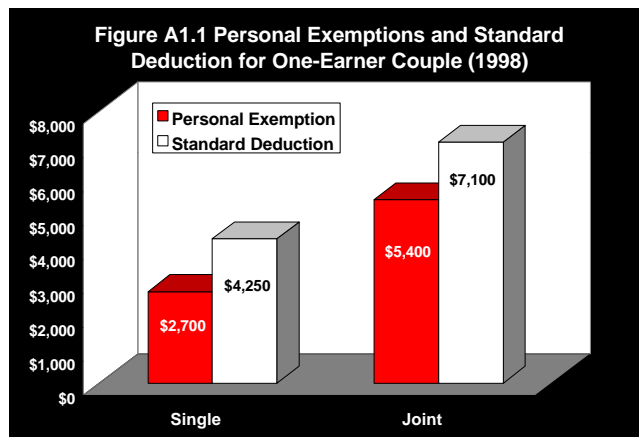
The standard deduction and marginal tax rate breakpoints can create marriage bonuses for married couples with largely unequal incomes. Table A1.1 shows the tax liability of a couple earning \$60,000 when all of the income is earned by one individual. If the worker is single, he/she incurs a federal income tax liability of \$11,559. However, if the worker marries a spouse with no earned income, their combined tax liability falls to \$7,795—a marriage bonus of \$3,764.

The bonus occurs for two reasons. First, when a worker marries a spouse with no earned income, the couple’s personal exemptions double and their standard deduction increases by \$2,850 (see Figure A1.1). Thus, the couple reduces their taxable income by \$5,550 when filing jointly. Second, under joint tax filing, the wage earner’s income is subject to wider tax brackets so that less income is taxed at 28 percent and more income is taxed at 15 percent (see Figure A1.2).

Table A1. 1 Sources of the Marriage Bonus

	Unmarried			Married
	Worker	Non-Worker	Combined	Joint Filing
AGI	\$60,000	\$0	\$60,000	\$60,000
- Standard Deduction	(4,250)	0	(4,250)	(7,100)
- Personal Exemption	(2,700)	0	(2,700)	(5,400)
Taxable Income	53,050	0	53,050	47,500
Marginal Tax Rate	28%	0%		28%
Tax Liability	\$11,559	\$0	\$11,559	\$7,795
Marriage Penalty/(bonus)				(\$3,764)

Source: Joint Economic Committee calculations



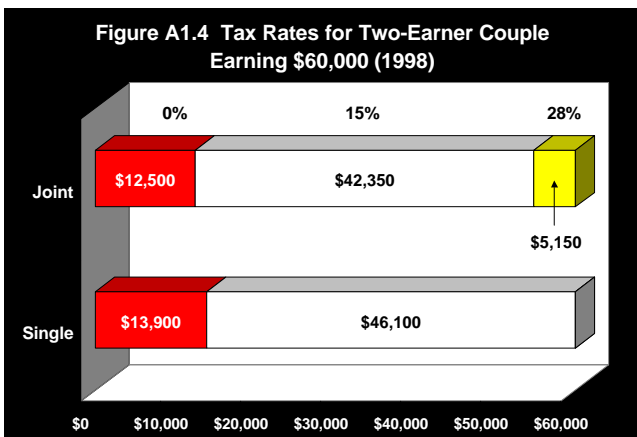
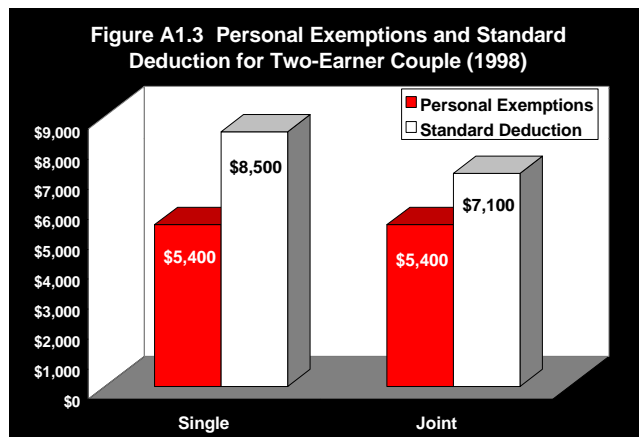
The same features of the tax code can create a marriage penalty when the income is more evenly divided between husband and wife. Table A1.2 outlines the tax liability of a couple earning \$60,000 when the income is divided equally between the two individuals. If the two individuals were single, they would file separate tax returns, and each would incur a federal income tax liability of \$3,457.50. Their combined tax liability would be \$6,915. However, if the two individuals were married, their total tax liability would be \$7,795. Thus, the couple’s income tax increases by \$880 upon marrying.

The penalty occurs for two reasons. First, when two individuals with earned income marry each other, their personal exemptions remain the same, but their standard deduction is reduced by \$1,400 (see Figure A1.3). As a result, their taxable income increases by this amount. Second, because the tax brackets for joint filers are not twice as wide as those for individual filers, some of their combined income is pushed out of the 15 percent tax bracket into the 28 percent tax bracket (see Figure A1.4).

Table A1.2 Sources of the Marriage Penalty

	Unmarried			Married
	Worker 1	Worker 2	Combined	Joint Filing
AGI	\$30,000	\$30,000	\$60,000	\$60,000
- Standard Deduction	(4,250)	(4,250)	(8,500)	(7,100)
- Personal Exemption	(2,700)	(2,700)	(5,400)	(5,400)
Taxable Income	23,050	23,050	46,100	47,500
Marginal Tax Rate	15%	15%		28%
Tax Liability	\$3,457.50	\$3,457.50	\$6,915	\$7,795
Marriage Penalty/(bonus)				\$880

Source: Joint Economic Committee calculations



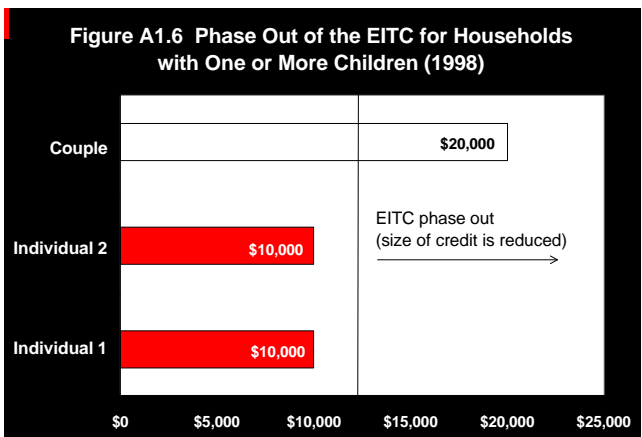
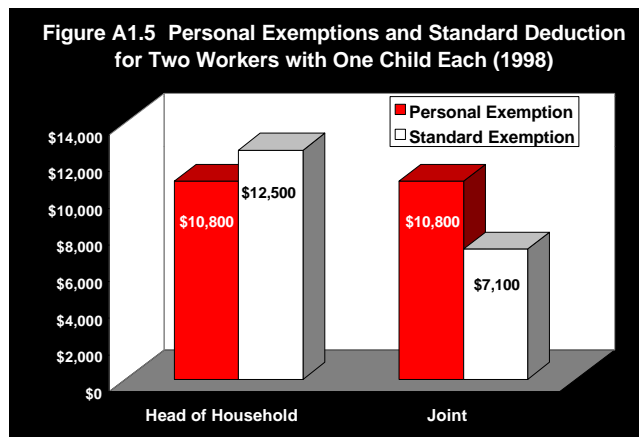
Consider a couple in which each individual has one child and each earns \$10,000. Table A1.3 shows that if the two individuals file as heads of households, they incur no federal income tax liability, and each receives the maximum EITC of \$2,271. Their combined income tax liability is negative \$4,542. If the two individuals are married, their tax liability is negative \$1,811—a marriage penalty of \$2,731, or 14 percent of total income.

The penalty occurs for three reasons. First, joint filing reduces the couple’s combined standard deduction by \$5,400 (see Figure A1.5). Thus, their taxable income increases by this amount and pushes them into the 15 percent tax bracket. Second, eligibility for the EITC begins to phase out at AGI \$12,260 regardless of filing status. Thus, each individual qualifies for the maximum credit if single, but if married, their combined income pushes them into the phase-out range of the EITC (see Figure A1.6) and reduces the size of the credit for which they qualify. Third, when the two individuals are single with one child each, they qualify for two separate tax credits worth a combined maximum value of \$4,542. However, combining their incomes and children into one household makes them eligible for only one credit worth a maximum of only \$3,756.

Table A1.3 EITC as a Source of Marriage Penalties

	Unmarried			Married
	Worker 1	Worker 2	Combined	Joint Filing
AGI	\$10,000	\$10,000	\$20,000	\$20,000
- Standard Deduction	(6,250)	(6,250)	(12,500)	(7,100)
- Personal Exemption	(5,400)	(5,400)	(10,800)	(10,800)
Taxable Income	0	0	0	2,100
Marginal Tax Rate	0%	0%		15%
Federal Income Tax	0	0	0	315
Earned Income Tax Credit	-2,271	-2,271	-4,542	-2,126
Total Tax Liability	-\$2,271	-\$2,271	-\$4,542	-\$1,811
Marriage Penalty/(bonus)				\$2,731

Source: Joint Economic Committee calculations



APPENDIX 2

EFFECT OF VARIOUS PROPOSALS ON MARRIED COUPLES

The following tables illustrate how the three main marriage penalty reduction proposals would affect hypothetical low-, middle- and high-income couples depending on their division of income. The analysis does not account for behavioral changes that might occur if any of the proposals were adopted.

Table A2.1 shows that none of the proposals would eliminate the structural penalty in the EITC. Therefore, a reduced penalty could exist for many EITC-eligible couples.

Table A2. Effect of Various Proposals on Tax Liability of Couple Earning \$20,000

	50-50 Income Split 10,000-10,000	100-0 Income Split 20,000-0	75-25 Income Split 15,000-5,000
Current Law			
Single tax liability	-\$4,542	-\$182	-\$3,031
Joint tax liability	-\$1,811	-\$1,811	-\$1,811
Penalty/(bonus)	\$2,731	(\$1,629)	\$1,220
Optional Filing			
Tax liability	-\$2,021	-\$1,811	-\$1,811
Tax cut	\$210	\$0	\$0
Penalty/(bonus)	\$2,521	(\$1,629)	\$1,220
Income Splitting (H.R. 3104 and H.R. 3734)			
Tax liability	-\$2,021	-\$2,021	-\$2,021
Tax cut	\$210	\$210	\$210
Penalty/(bonus)	\$2,521	(\$1,839)	1,010
Second-Earner Deduction			
Tax liability	-\$1,961	-\$1,811	-\$1,886
Tax cut	\$150	\$0	\$75
Penalty/bonus	\$2,581	(\$1,629)	\$1,145

Notes: (1) Assumes each spouse has one child for EITC calculation. (2) Calculations reflect the child tax credit that will be effective in 1998.

Source: Joint Economic Committee calculations

Table A2.2 shows that for middle-income couples, optional filing would eliminate penalties and maintain bonuses. Couples with the same income could pay different amounts of income tax. Income splitting would eliminate penalties and increase bonuses. Couples with the same income would receive equal tax cuts, thus maintaining horizontal equity. The second-earner deduction would reduce or eliminate penalties for two-earner couples. The third example shows that the deduction would increase bonuses for two-earner couples who receive them under current law. One-earner couples would not be affected by the deduction. One-earner couples would continue receiving the largest bonuses under all of the proposals.

Table A2.2 Effect of Various Proposals on Tax Liability of Couple Earning \$60,000

	50-50 Income Split 30,000-30,000	100-0 Income Split 60,000-0	75-25 Income Split 45,000-15,000
Current Law			
Single tax liability	\$6,915	\$11,559	\$8,567
Joint tax liability	\$7,795	\$7,795	\$7,795
Penalty/(bonus)	\$880	(\$3,764)	(\$772)
Optional Filing			
Tax liability	\$6,915	\$7,795	\$7,795
Tax cut	\$880	\$0	\$0
Penalty/(bonus)	\$0	(\$3,764)	(\$772)
Income Splitting (H.R. 3104 and H.R. 3734)			
Tax liability	\$6,915	\$6,915	\$6,915
Tax cut	\$880	\$880	\$880
Penalty/(bonus)	\$0	(\$4,644)	(\$1,652)
Second-Earner Deduction			
Tax liability	\$6,955	\$7,795	\$7,375
Tax cut	\$840	\$0	\$420
Penalty/bonus	\$40	(\$3,764)	(\$1,192)

Note: Assumes the standard deduction and two personal exemptions

Source: Joint Economic Committee calculations

Table A2.3 shows that for high-income couples, a reduced penalty may exist because of the phase-out provisions of various tax breaks. (Certain phase-out provisions can create reduced penalties for middle-income couples as well.) In this example, income-splitting results in a reduced penalty for the couple with a 50-50 income split. The penalty arises because of the limitation of itemized deductions. (The value of itemized deductions is reduced for taxpayers with AGI more than \$124,500 regardless of filing status. Thus, two individuals earning \$75,000 each can take full advantage of their deductions when single, but when married to each other, they must limit their deductions because their combined income of \$150,000 pushes them beyond the phase-out threshold.) Under optional filing, this particular structural penalty is eliminated, although other phase-out provisions can create penalties for some couples. The second-earner deduction reduces the tax liabilities of the two-earner couples by \$930. This amount reflects the value of a \$3,000 deduction at the 31 percent tax rate ($\$3,000 * 0.31$).

Table A2.3 Effect of Various Proposals on Tax Liability of Couple Earning \$150,000

	50-50 Income Split 75,000-75,000	100-0 Income Split 150,000-0	75-25 Income Split 112,500-37,500
Current Law			
Single tax liability	\$26,338	\$32,561	\$27,183
Joint tax liability	\$28,119	\$28,119	\$28,119
Penalty/(bonus)	\$1,781	(\$4,442)	\$936
Optional Filing			
Tax liability	\$26,338	\$28,119	\$27,183
Tax cut	\$1,781	\$0	\$936
Penalty/(bonus)	\$0	(\$4,442)	\$0
Income Splitting (H.R. 3104 and H.R. 3734)			
Tax liability	\$26,552	\$26,552	\$26,552
Tax cut	\$1,567	\$1,567	\$1,567
Penalty/(bonus)	\$214	(\$6,009)	(\$631)
Second-Earner Deduction			
Tax liability	\$27,189	\$28,119	\$27,189
Tax cut	\$930	\$0	\$930
Penalty/bonus	\$851	(\$4,442)	\$6

Note: Assumes couples claim itemized deductions equal to 18 percent of AGI when single and when filing jointly.

Source: Joint Economic Committee calculations