THE MARRIAGE TAX PENALTY

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PREFACE

Most two-earner married couples pay more Income tax than they would if single. This paper, prepared at the request of Chairman Dan Rostenkowski of the House Committee on Ways and Means, examines the size of these so-called marriage penalties under current law and after enactment of pending individual income tax proposals, including the Administration's across-the-board rate cuts and several of the proposals designed explicitly to reduce marriage penalties. It also compares the proposals in terms of their effects on work incentives. This paper does not include complete estimates of the revenue losses from the proposals or the distribution of tax savings by income group. The staff of the Joint Committee on Taxation is preparing this information. In accordance with CBO's mandate to provide objective analysis, this report offers no recommendation.

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CHAPTER 1. INTRODUCTION

The structure of pending individual income tax cut proposals has stirred debate on a number of tax issues, including the so-called marriage penalty. This is the additional tax many working married couples pay compared to what they would pay if single. The penalty is the difference between the tax liability of the married couple and the combined tax liabilities of the spouses calculated using the schedule for single taxpayers. The debate on the marriage penalty centers on two issues:

- Would the dollar amount of the marriage penalty increase or decrease for most couples after full implementation of the Administration's proposed 30 percent across-the-board rate reductions?

- Would a targeted reduction in the marriage penalty induce a larger or smaller increase in the labor force than an across-the-board rate cut of the same overall size?

This report discusses both questions using calendar years 1981 and 1984 as the points of reference.

The marriage penalty and suggested ways of reducing it should be considered in the context of a broader problem of which it is part.[1] There are three basic, generally accepted principles of income taxation that cannot all be simultaneously attained--progressivity, equal taxation of families with equal incomes, and marriage neutrality. (Marriage neutrality is achieved when an individual's tax bill remains unchanged if he marries or divorces.) The present system of taxation violates all but

1. For an excellent discussion of the history of the marriage tax penalty and the difficulty of making the tax code marriage-neutral, see The Income Tax Treatment of Married Couples and Single Persons prepared by the Joint Committee on Taxation for the House Committee on Ways and Means and the Senate Finance Committee, 96:2 (April 1980).

progressivity.[2] Perfect marriage neutrality, which implies elimination of the marriage penalty (and also the single penalty) could be accomplished only by giving up one of the other two principles. (See Appendix A for an explanation of why this is so.) It would come about if the tax system were made proportional, instead of progressive, or if the individual rather than the family became the unit of taxation, with one tax schedule applying to all individuals.

Short of moving directly either to a proportional tax system or to taxing individuals instead of families (called mandatory individual filing), the marriage penalty can never be. eliminated without at the same time imposing a greater tax burden on single taxpayers and/or taxing differently couples with the same combined income. Marriage neutrality could be improved, however, by compromising on one of the other principles. Making the rate structure less progressive could greatly reduce marriage penalties without introducing any new complexity into the tax code and without greatly worsening penalties on single taxpayers.[3] At the same time, married couples with equal incomes would continue to pay the same tax. The proposals to reduce the marriage penalty directly, which are the focus of this study, would preserve the

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2. Prior to 1948, the income tax system was basically marriage-neutral and progressive, but treated married couples with equal incomes unequally. Since 1948, the system has retained its progressivity and generally treated married couples with equal incomes equally. It has, however, no longer been marriage neutral, at times containing single penalties or marriage penalties of varying degrees. From 1948 to 1969, there was no marriage penalty, but there were rather large single penalties. In other words, singles often paid much more tax than if they had been married to nonworlcing spouses. To alleviate this situation, the Congress in 1969 reduced but did not completely eliminate the penalties for singles. This change in the tax system, however, created marriage penalties for the first time.

3. This could be done by tailored widening of the tax brackets or by reducing tax rates. Not all rate cuts or forms of bracket widening would substantially lessen marriage penalties, however. See Joint Committee on Taxation, Background and Issues Relating to Individual Income Tax Reductions (April 27, 1981).

progressivity of the tax system but would stray further from the principle of equal taxation of families with equal income.

CHAPTER II. MAGNITUDE OF MARRIAGE TAX PENALTY

CURRENT LAW

Table 1 shows the dollar amounts of the marriage tax penalty for representative couples. The first line of Table 1, for instance, shows the total tax liability and marriage penalty for a couple with a combined income of $15,000, 90 percent of which is earned by the primary worker (the spouse with larger earnings), and 10 percent by the secondary worker.[1] The marriage penalty for this couple is minus $145. Since the penalty is negative in this case, this working couple actually receives a marriage tax bonus--that is, by being married, the spouses pay less tax than they would if single. At the same combined $15,000 income level but with a more even distribution of earnings between husband and wife, the couple pays a marriage penalty. The second and third lines of Table 1 show this penalty as $197 for a couple with a 67/33 income split, increasing to $240 for a 50/50 split.

AFTER TAX REDUCTIONS

Table 1 also shows the marriage penalties that would remain after enactment of various tax reductions currently under consideration.

Administration's Rate Cuts. The Administration's proposed 5 percent across-the-board rate reduction for 1981 would reduce slightly the amounts of marriage penalties or bonuses for most couples. If the Administration's proposed 30 percent rate reduction were put into effect immediately, it would lessen the penalty

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1. The numerical examples assume throughout that the couples have no investment income and no dependents. A couple's itemized deductions are assumed to be 23 percent of its combined adjusted gross income. If this is less than the zero bracket amount (formerly called the standard deduction), however, the couple is assumed not to itemize. In calculating each spouse's tax liability as a single taxpayer, the same rule is used.

TABLE 1. REMAINING MARRIAGE PENALTIES OF SELECTED COUPLES UNDER CURRENT LAW AND AFTER VARIOUS TAX LAW CHANGES, FOR CALENDAR YEAR 1981[a] (In dollars)

Combined Adjusted Gross Income	Tax Liability Under Current Law	Marriage Penalty[b]					
		Current Law	5 Percent General Rate Reduction[c]	30 Percent General Rate Reduction[c]	10 Percent Two-Earner Deduction[d]	Marriage Tax Credit[e]	Modified Marriage Tax Credit[f]
15,000 Income split							
90/10	1,624	-145	-147	-104	-177	-145	-145
67/33	1,624	197	186	169	93	-8	0
50/50	1,624	240	229	213	83	-11	0
25,000 Income split							
90/10	3,399	-311	-284	-190	-381	-311	-311
67/33	3,399	168	164	171	-48	-224	0
50/50	3,399	229	229	220	-89	-382	0
40,000 Income split							
90/10	7,052	-577	-526	-363	-725	-577	-577
67/33	7,052	502	496	432	14	-709	0
50/50	7,052	822	780	667	82	-870	0
60,000 Income split							
90/10	13,602	-902	-890	-577	-1,196	-902	-902
67/33	13,602	1,579	1,537	1,320	620	-1,085	0
50/50	13,602	2,166	2,124	1,733	768	-1,488	0
100,000 Income split							
90/10	28,878	-241	-437	-1,279	-741	-600	-241
67/33	28,878	3,172	3,270	2,762	1,672	-1,022	0
50/50	28,878	3,760	4,086	3,597	2,260	-634	0

a. Couples have no Investment income or dependents. Itemized deductions are 23 percent of adjusted gross income.

b. The marriage penalty is the difference between the tax the couple pays married and filing jointly compared to the sum of what the spouses would pay if single. A minus (-) sign indicates a marriage bonus, that is, a married couple would pay less than if they were single.

c. The tax rates used in making these calculations are those of the Administration's proposed rate reductions, which only approximate precise 5 and 30 percent reductions, and which do not explicitly lower the maximum tax rate on earned income.

d. A deduction is allowed for 10 percent of the first $30,000 of earnings of the lesser-earning spouse.

e. A credit is allowed for the amount of marriage penalty that would occur if the couple had no investment income, no dependents, and no itemized deductions.

f. A credit is allowed for the amount of marriage penalty that would occur if the couple had no investment income, no dependents, and itemized deductions of 23 percent of adjusted gross income.

for nearly all couples, in some cases by as much as 20 percent (see Table 1).[2] Under the Administration's 30 percent tax cut, most two-earner couples would continue to pay marriage penalties of several hundred dollars, however, and some high-income couples would continue to pay penalties of several thousand dollars.

For calendar year 1981, the federal revenue loss from a 5 percent rate reduction would be about $15 billion, and the loss from a 30 percent rate reduction would be about $80 billion (based on an effective date of January 1, 1981).

Deduction for Two-Earner Married Couples. Allowing married couples a deduction of ten percent of the first $30,000 of earnings of the lesser-earning spouse would do far more than either rate cut to lower marrriage penalties (see Table 1). The calendar year 1981 revenue loss from this proposal would be about $6 to 7 billion (based on an effective date of January 1, 1981). This kind of deduction was passed by the Senate Finance Committee last summer and endorsed by the Carter Administration. It would be relatively simple to administer, requiring only a few additional lines on the tax forms.

As most commonly proposed, the deduction would be allowed for all two-earner couples, regardless of the size of their penalty (if any). It would therefore greatly overcompensate for the marriage penalty in many instances, increasing existing marriage bonuses and creating bonuses for many couples who now pay a marriage penalty. At the same time, primarily because the deduction would be capped at $3,000, it would still leave some high-income couples (mostly those in which both spouses make over $30,000) with penalties of over $1,000.

The large marriage bonuses created by the deduction could be scaled down if the deduction were applied only to the second worker's earnings in excess of a fixed dollar amount, say $2,500, or if a deduction were allowed only for couples in which the lesser-earning spouse contributed at least 20 percent of the couple's combined earnings. The latter approach, which roughly

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2. A uniform 30 percent rate reduction would necessarily reduce all marriage bonuses and penalties by exactly 30 percent, but the Administration's proposal would not, in fact, reduce all tax rates by exactly 30 percent.

targets the deduction on couples that now pay a penalty, is taken in H.R. 177, introduced by Representative Conable.[3] The large penalties remaining for high-income couples could be reduced by increasing or removing the cap on the deduction.[4] CBO has calculated remaining penalties under several proposals with different floors and caps, and some of the results appear in Appendix B.

Marriage Tax Credit. A tax credit for two-earner married couples would work differently from a two-earner deduction. After completing its return in the present manner, each couple would consult a special tax table to determine the amount of credit it would be entitled to, and then subtract that amount from its tax bill. (A sample marriage tax credit table is shown in Appendix

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3. A disadvantage of this approach is that it produces so-called "notch" effects, where just a dollar of extra income going to the lesser-earning spouse could mean the difference between qualifying and not qualifying for the deduction and receiving, in the most extreme cases, up to $1,000 of tax savings.

4. Removing the cap on the deduction would, however, grant very affluent two-earner couples large marriage bonuses. The marriage penalty on earned income peaks at about $3,800 when both spouses have earnings of roughly $55,000. Further increases in income on the part of either spouse do not affect the size of the penalty, since they are taxed at the 50 percent maximum rate regardless of the spouses' marital status. Couples in which both spouses earned $55,000 would be entitled to a deduction of $5,500, for a tax savings of $2,750 [$2,750 = (.50)($5,500)]. Since their marriage penalty under current law is about $3,800, this would leave them with a penalty of about $1,050. Under an uncapped deduction, every dollar of extra income earned by the second earner would entitle the couple to additional tax savings. As the second earner's income rose, this extra tax savings would offset more and more of the initial $3,800 marriage penalty. Couples in which both spouses earned about $75,000 would be left with no marriage penalties, and those with higher earnings would get ever-increasing marriage bonuses.

C.)[5] The entries in the table would be calculated by the IRS to be the amount of penalty experienced by the couples with each income configuration, based on assumptions spelled out in the authorizing legislation about investment income, itemized deductions, and dependents. Couples who now receive a marriage bonus would generally be entitled to credits of zero, so they would pay the same tax under the credit as they do under present law.[6]

Senator Moynihan and Representative Shannon have introduced bills for marriage tax credits (S.775 and H.R.2474). In both cases, the table entries for the credit are implicitly calculated on the assumption that taxpayers have no investment income and do not itemize deductions. Taxpayers with these characteristics--nonitemizers with no investment income--would have their penalties precisely offset by this proposal, but nearly all other couples would be left with marriage penalties or bonuses. Table 1 (second-to-last column) shows the rather large bonuses that would be created by this proposal for couples who itemize their deductions but have no investment income. The large bonuses come about because itemizers pay a lesser penalty than nonitemizers at the same income level. The credit, which would offset the penalty of nonitemizers, would, therefore, exceed the penalty of itemizers.

The credit could be redesigned in a way that would, on average, solve this overcompensation problem and just offset the

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5. The one-page table in Appendix C is illustrative only. Because the income brackets in this table are relatively wide, a one dollar wage increase would, in some cases, entitle couples to additional tax savings of over $1,000. Narrower income brackets would reduce these "notch" problems, but could only be achieved with a multipage table.

6. Depending on the assumptions used. in designing the credit table, some couples who now receive a marriage bonus could actually be entitled to a credit. This would increase their marriage bonuses.

marriage penalty on earned income.[7] Instead of basing the credit on the marriage penalty of nonitemizers, the Congress could base the credit on the amount of penalty paid by couples with the average amount of itemized deductions (currently about 23 percent of adjusted gross income). The credit could be set equal to zero for couples who now enjoy marriage bonuses, leaving them with their current bonuses. The last column of Table 1 shows the marriage penalties remaining after enactment of this version of the marriage tax credit. Because the representative couples in the table are assumed to take the average deductions for their income group, and because the credit is designed to offset precisely the penalty for the "average" couples, this credit leaves most of the representative couples with penalties of zero. While it is true that this version of the credit would just eliminate penalties on earned income for these average couples, it would leave nonitemizers with some penalty and would create bonuses for married couples with larger than average deductions.

The credit table entries for S. 775 are calculated on the assumption that couples have one dependent, while H.R. 2474 assumes two dependents. Since the greater the number of dependents the smaller the marriage penalty, some couples with no children would be left with marriage penalties under both proposals, and those with large families would get large bonuses.

Because the amount of each couple's marriage penalty depends on so many individual facts and circumstances--number of dependents, amount of itemized deductions, amount of investment income and tax shelter losses--no one credit table could ever eliminate all marriage penalties. If the number of tables were increased to deal with these differences, the credit would come closer to

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7. The credit thus designed would offset only the penalty associated with earned income (as opposed to investment income). Since the work disincentives of the marriage penalty stem from the penalty on earned income and since it is difficult to settle on a fair and universal rule for allocating investment income between husband and wife, most people feel it is important only to correct for the penalty on earned income.

eliminating all marriage penalties, but would be much more complicated for taxpayers to use.[8]

THE IMPACT OF INFLATION

If there were no inflation between now and 1984 and no changes in the tax law other than those considered in Table 1, the amounts of marriage penalty in the table would be valid for L984 as well as for 1981. If inflation pushed up nominal wages between now and then, however (or if real economic growth resulted in higher incomes), and no tax cuts were enacted other than those individually considered in Table 1, "bracket creep" would alter the real amount of the marriage penalty in all cases.

In Table 2, therefore, the numbers for 1984 are calculated on the assumption that nominal wages increase with the inflation rate between 1981 and 1984.[9] All numbers in Table 2 are expressed in constant 1981 dollars so that it is possible to compare the dollar

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8. One of the advantages of the simple, one-table credit is that it achieves roughly the same result as optional single filing, without requiring couples to calculate their taxes two ways--as singles and as a married couple--in order to determine which is more advantageous. Clearly, as more and more credit tables were added, this advantage would be eroded, and at some point the credit would be more complicated than optional single filing.

9. The assumptions about the future rates of inflation are from CBO's February 14, 1981 economic forecast. The inflation rate is assumed to be 11.3 percent in 1981, 9.5 percent in 1982, and 9.0 percent in 1983, for an overall inflation rate of 32.8 percent between 1981 and 1984. To the extent that the different tax cut proposals considered here could, in and of themselves, affect the inflation rate, it is an oversimplification to consider only one rate.

TABLE 2. REMAINING MARRIAGE PENALTIES OF SELECTED COUPLES[a] UNDER CURRENT LAW AND AFTER VARIOUS TAX LAW CHANGES, ASSUMING THAT NOMINAL WAGES KEEP PACE WITH INFLATION,[b] FOR CALENDAR TEAR 1984 (In constant 1981 dollars)

Combined Adjusted Gross Income	Tax Liability Under Current Law 1981	Tax Liability Under Current Law 1984	Marriage Penalty[c] Under Current Law 1981	Marriage Penalty[c] Under Current Law 1984	Marriage Penalty[c] in 1984 After: 30 Percent General Rate Reduction[d]	10 Percent Two-Earner Deduction[e]	Marriage Tax Credit[f]	Modified Marriage Tax Credit[g]
15,000								
Income split								
90/10	1,624	1,839	-145	-146	-114	-182	-146	-146
67/33	1,624	1,839	197	132	111	13	-74	0
50/50	1,624	1,839	240	79	103	-95	-214	0
25,000								
Income split								
90/10	3,399	3,962	-311	-319	-198	-399	-319	-319
67/33	3,399	3,962	168	216	228	-48	-314	0
50/50	3,399	3,962	229	398	326	-2	-439	0
40,000								
Income split								
90/10	7,052	8,446	-577	-614	-370	-786	-614	-614
67/33	7,052	8,446	502	954	789	386	-745	0
50/50	7,052	8,446	822	1,258	1,012	398	-990	0
60,000								
Income split								
90/10	13,602	15,855	-902	-472	-588	-772	-472	-472
67/33	13,602	15,855	1,579	1,887	1,569	897	-836	0
50/50	13,602	15,855	2,166	2,554	2,109	1,426	-715	0
100,000								
Income split								
90/10	28,878	31,255	-241	354	-1,397	-146	-599	0
67/33	28,878	31,255	3,172	2,808	2,369	1,679	-500	0
50/50	28,878	31,255	3,760	2,857	3,219	1,727	-452	0

a. Couples have no investment income or dependents. Itemized deductions are 23 percent of adjusted gross income.

b. The inflation rate is assumed to be 11.3 percent in 1981, 9.5 percent in 1982, and 9.0 percent in 1983.

c. The marriage penalty is the difference between the tax the couple pays married and filing jointly compared to the sum of what the spouses would pay if single. A minus (-) sign indicates a marriage bonus, that is, a married couple pays less than if they were single.

d. The tax rates used in making these calculations are those that would prevail in 1984 after full implementation of the Administration's proposed rate reductions. These reductions only approximate a precise 30 percent across-the-board reduction, and would not explicitly lower the maximum tax rate on earned income.

e. A deduction is allowed for 10 percent of the first $30,000 of earnings of the lesser-earning spouse.

f. A credit is allowed for the amount of marriage penalty that would occur if the couple had no investment income, no dependents, and no itemized deductons.

g. A credit is allowed for the amount of marriage penalty that would occur if the couple had no investment income, no dependents, and itemized deductions of 23 percent of adjusted gross Income.

amount of the marriage penalties of the representative couples in 1981 (Table 1) with the dollar amount of the penalties in 1984 assuming that the couples' incomes just kept pace with inflation.[10]

In the absence of any tax cuts between now and 1984, bracket creep would push up the tax liabilities of all couples. (See columns 1 and 2 of Table 2 for tax liabilities under current law for 1981 and 1984.) A couple whose income was $15,000 in 1981 would have income in 1984 of $19,926 if its income just kept pace with inflation. On this income, the couple would pay a tax of $2,443 in 1984 dollars, which would have the purchasing power of $1,839 in constant 1981 dollars (see Table 2, column 2).[11] This couple, whose 1981 tax bill is $1,624 (see Table 2, column 1), would pay $215 more in tax (in real terms) in 1984 ($1,839 minus $1,624 = $215). The same kind of calculation shows that bracket creep alone would increase the marriage penalty for some and decrease it for others (compare columns 3 and 4 in Table 2).

If the only individual tax cut enacted between now and 1984 were a general 30 percent rate reduction, and if CBO's assumption about inflation is correct, marriage penalties for some couples would actually be greater in 1984 than they are today (see Table 2, column 5), and penalties for many affluent couples would still amount to over a thousand dollars. On the other hand, Table 2 shows that the bonuses and penalties of many other couples would be reduced.

The last three columns of Table 2 show marriage penalties remaining in 1984 on the admittedly unrealistic assumption that the only tax cut enacted by then was some form of marriage penalty reduction. The conclusions drawn above for the relative effects of these proposals on marriage penalties in 1981 generally hold true for 1984 as well.

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10. Under this assumption, the couple with a $15,000 income in 1981, for example, would have an income of $19,926 in 1984. Since this income would have the purchasing power of $15,000 in 1981 dollars, the couple is shown in Table 2 as still having an income of $15,000 ($19,926 = $15,000 x 1.328).

11. $1,839 = $2,443/1.328.

CHAPTER III. WORK INCENTIVES AND TAX RATES FOR SECONDARY WORKERS

The work decisions of secondary workers are influenced to a far greater degree by marginal and average tax rates than are work decisions of primary workers. Recent empirical evidence suggests that a 10 percent cut in marginal tax rates increases by 1 percent the hours worked by married men and by 4 percent those worked by married women.[1] This implies that total work hours would increase more if part of an individual income tax cut were used specifically to reduce tax rates for secondary workers (mostly married women) rather than using the entire cut for across-the-board rate reductions.[2]

For income tax purposes, the income of the secondary worker essentially is "stacked" on top of the income of the primary

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1. Jerry Hausman, "Income and Payroll Tax Policy and Labor Supply," National Bureau of Economic Research Working Paper No. 610 (December 1980), pp. 25-26. Even in the face of high marginal and average tax rates, an increasing share of married women has entered the work force over the past decade. This does not refute Hausman's findings, however, since there might have been an even larger surge in labor force participation had tax rates been lower.

2. Hausman studied the labor supply responses of married men versus married women. Since statistically most husbands are primary workers (the spouse with larger earnings), Hausman's results can be used to support the proposition that marriage penalty reductions (which are directed at secondary workers, rather than specifically at wives) encourage more work effort than across-the-board rate cuts of the same size. Throughout the following discussion, for the sake of expository ease, the term "married woman" is used to represent the secondary earner (the spouse with smaller income), even though many wives earn more and are more permanent members of the labor force than their husbands.

worker. The tax rate applying to the first dollar of the secondary worker's earnings is, therefore, the rate applying to the last dollar of the primary worker's earnings. This is a much higher rate than the rate the wife would pay if not married. A woman married to a highly paid executive can, for example, face a federal income tax rate of 50 percent on her first dollar of earnings.[3]

In order to understand how the present rate structure or contemplated changes to it might affect the work decisions of married women, it helps to consider several different tax rates. If a wife does not currently have a paying job and is deciding whether to accept a specific job offer, she will decide partly on the basis of whether the take-home pay would make it worthwhile. The most relevant tax rate in this case is the average tax rate on this income. If a woman was deciding whether to pursue career advancement and a salary increase, or deciding whether to leave a part-time job in favor of a full-time job, the relevant tax rate is the tax rate on the added income from the raise. This is approximately the wife's marginal tax rate on her present earnings.

CURRENT LAW

Table 3 shows the average tax rates representative wives would face if they took paying jobs. Under current law, for instance, a secondary worker with a potential income of $1,000 married to someone making $9,000 would face an average tax rate of 17 percent on her earnings. If she got a job paying $9,000 a year instead of $1,000, her average tax rate would be 18 percent.

Table 4 shows the marginal tax rates that would apply to pay raises of secondary workers. For example, if both spouses earn $9,000 a year, the secondary worker would face a tax rate of 21 percent on a dollar of pay raise under current law (column 1, Table 4). A woman earning $5,500 a year and married to a man

3. Adding in social security taxes and state income taxes would raise her beginning tax rate even higher.

TABLE 3. EFFECTS OF VARIOUS TAX LAW CHANGES ON AVERAGE TAX RATES, FOR CALENDAR YEAR 1981[a]

Adjusted Gross Income (In Dollars)		Average Tax Rates For Secondary Workers (In Percents)[b]				
Primary Worker	Secondary Worker	Current Law	5 Percent General Rate Reduction[c]	30 Percent General Rate Reduction[c]	10 Percent Two-Earner Deduction[d]	Modified Marriage Tax Credit[e]
9,000	1,000	17	16	12	15	17
9,000	4,500	18	17	13	16	14
9,000	9,000	18	17	13	15	16
18,000	2,000	17	17	13	15	17
18,000	9,000	19	18	14	16	17
18,000	18,000	21	20	16	18	18
27,000	3,000	22	21	16	19	22
27,000	13,500	25	24	18	21	21
27,000	27,000	28	27	21	24	22
50,000	5,500	33	32	25	29	33
50,000	25,000	36	35	27	31	27
50,000	50,000	37	37	29	34	30

a. The estimated calendar year 1981 revenue losses from these proposals are about $15 billion from a 5 percent rate reduction, about $80 billion from a 30 percent rate reduction, $6 to $7 billion from a 10 percent two-earner deduction and roughly $5 to $10 billion from a marriage tax credit (based on effective dates of January 1, 1981).

b. Couples have no investment income or dependents. Itemized deductions are 23 percent of adjusted gross income.

c. The tax rates used in making these calculations are those of the Administration's proposed rate reductions, which only approximate precise 5 and 30 percent reductions, and which do not explicitly lower the maximum tax rate on earned income.

d. A deduction is allowed for 10 percent of the first $30,000 of earnings of the lesser-earning spouse.

e. A credit is allowed for the amount of marriage penalty that would occur if the couple had no investment income, no dependents, and itemized deductions of 23 percent of adjusted gross income.

TABLE 4. EFFECTS OF VARIOUS TAX LAW CHANGES ON MARGINAL TAX RATES FOR CALENDAR YEAR 1981[a]

Adjusted Gross Income (In dollars)		Marginal Tax Rates for Secondary Workers (In percents)[b]					Primary Workers' Marginal Tax Rate (In percents)	
Primary Worker	Secondary Worker	Current Law	5 Percent General Rate Reduction[c]	30 Percent General Rate Reduction[c]	10 Percent Two-Earner Deduction[d]	Modified Marriage Tax Credit[e]	Current Law	Modified Credit[e]
9,000	1,000	18	17	13	16	18	18	18
9,000	4,500	18	17	13	16	16	18	19
9,000	9,000	21	20	15	19	19	21	19
18,000	2,000	24	23	18	22	24	24	24
18,000	9,000	28	27	21	25	19	28	30
18,000	18,000	32	30	23	29	30	32	30
27,000	3,000	28	27	21	25	28	28	28
27,000	13,500	37	35	27	33	24	37	34
27,000	27,000	43	41	32	39	34	43	34
50,000	5,500	43	41	32	39	43	43	43
50,000	25,000	49	47	36	44	34	49	49
50,000	50,000	50	50	40	50	49	50	49

a. The estimated calendar year 1981 revenue losses from these proposals are about $15 billion from a 5 percent rate reduction, about $80 billion from a 30 percent rate reduction, $6 to $7 billion from a 10 percent two-earner deduction and roughly $5 to $10 billion from a marriage tax credit (based on effective dates of January 1, 1981).

b. Couples have no investment income or dependents. Itemized deductions are 23 percent of adjusted gross income.

c. The tax rates used in making these calculations are those of the Administration's proposed rate reductions, which only approximate precise 5 and 30 percent reductions, and which do not explicitly lower the maximum tax rate on earned income.

d. A deduction is allowed for 10 percent of the first $30,000 of earnings of the lesser-earning spouse.

e. A credit is allowed for the amount of marriage penalty that would occur if the couple had no investment income and had itemized deductions of 23 percent of adjusted gross income.

earning $50,000 a year would face a marginal tax rate of 43 percent.

EFFECTS OF TAX REDUCTIONS

Administration's Rate Cuts. The 5 and 30 percent across-the-board rate reductions would lower (by 5 and 30 percent respectively) the marginal tax rates of both primary and secondary workers (see columns 2 and 3 of Table 4.) They would also lower average tax rates by approximately 5 and 30 percent respectively (see columns 2 and 3 of Table 3).

Two-Earner Deduction. The deduction of 10 percent of the first $30,000 of earnings of the secondary worker would leave unchanged the average and marginal tax rates of primary workers. For secondary workers whose incomes fall below the $30,000 cap, however, the deduction would have the effect of reducing both average and marginal tax rates by 10 percent.[4] For those with incomes above $30,000, average tax rates would drop by less than 10 percent, and marginal tax rates would almost always be unchanged.[5] An uncapped 10 percent deduction would be equivalent to a 10 percent rate cut targeted on secondary workers and would elicit about the same work response on the part of secondary workers as would a 10 percent across-the-board rate cut.[6]

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4. The primary worker's marginal rate could drop slightly and the marginal rate reduction for the secondary worker could be slightly more than 10 percent if, by chance, the couple's combined income put them just over a tax bracket delineator, so that with the deduction they slid down a bracket. Brackets widen as incomes increase, making this extra reduction extremely unlikely, at high combined incomes.

5. The only possible marginal rate reduction in this case would occur if the deduction happened to bring the couple's taxable income down a bracket. At the high combined income levels at which the cap becomes binding, however, brackets are very wide (partly because of the 50 percent maximum rate on earned income), making this rate reduction highly unlikely.

6. The revenue loss of the capped marriage deduction would be about $6 to 7 billion in 1981, compared to a revenue loss of about $15 billion for a 5 percent across-the-board rate cut (both based on effective dates of January 1, 1981).

Marriage Tax Credit. Allowing couples a marriage tax credit would be roughly equivalent to letting them file as single taxpayers. As currently conceived, the marriage credit is, in fact, equivalent to optional single filing for couples who have no investment income and who do not itemize deductions.[7]

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7. $$\text{Credit} = \max \left\{ 0,\ T_m^{sd}(Y_h^e + Y_w^e) - [T_s^{sd}(Y_h^e) + T_s^{sd}(Y_w^e)] \right\}$$

where $T_m^{sd}(Y)$ = tax on income of Y, calculated on the married (m) schedule, with the standard deduction (sd)

$T_s^{sd}(Y)$ = tax on income of Y, calculated on the single (s) schedule, with the standard deduction (sd).

Y_h^e = earnings (e) of husband (h).

Y_w^e = earnings (e) of wife (w).

But if the couple has no investment income and doesn't itemize deductions, then their tax bill would be

$$T_m^{sd}(Y_h^e + Y_w^e) - \text{Credit} = \min \left\{ T_m^{sd}(Y_h^e + Y_w^e),\ T_s^{sd}(Y_h^e) + T_s^{sd}(Y_w^e) \right\}$$

which is optional single filing.

The analogy between the marriage credit and optional single filing is not as precise for couples with investment income or itemized deductions. One of the strengths of the marriage credit proposal is that it skirts the problem of allocating investment income and itemized deductions between spouses. At the same time, however, only couples in which each spouse's investment income equals his excess itemized deductions (deductions in excess of the zero bracket amount) currently pay exactly the marriage penalties that would be offset by the credit.

If the couple's investment income exceeds excess itemized deductions, the marginal tax rate of the secondary worker could be greater than the rate taken directly from the singles schedule. This is because each additional dollar of family earnings, regardless of whether earned by husband or wife, could push the investment income (minus deductions) into a higher tax bracket.

Couples who now get a marriage bonus would generally be entitled to marriage tax credits of zero. Therefore, these couples' tax bills would be unchanged from current law, as would their average and marginal tax rates. In the case of couples who now pay a marriage penalty, however, a marriage tax credit would lessen, to a great exent, the link between husband's and wife's tax rates.[8] Each would essentially pay tax separately on his or her earnings, using the rates from the schedule for single taxpayers. The marriage tax credit plans introduced in the Congress and the modified version described above have very similar effects on marginal and average tax rates, so only the rates for the modified version are reported in Tables 3 and 4. As seen in these tables, the credit would not change tax rates for secondary workers in couples that now receive a marriage bonus (generally the first couple in each income grouping). It would, however, sharply lower average and, particularly, marginal tax rates for most other secondary workers.[9]

Since the tax credit proposal would be similar to optional single filing, it would alter the tax rates for primary workers as well as those for secondary workers. Primary workers in those couples now paying a penalty also would essentially pay tax according to the single schedule. Because of this, some primary workers would face higher marginal tax rates than they do under current law. The last two columns in Table 4 show the tax rate on the last dollar of the primary worker's earnings under current law

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8. The tax rate on the couple's investment income would still be influenced by the earnings of both spouses, however.

9. An unusual characteristic of the marriage credit proposal is that marginal tax rates of secondary workers rise, fall, and then rise again as the secondary worker's income increases. The marginal tax rate on the first dollar of the woman's earnings is the marginal rate on the couple's combined income. This relationship holds until the wife's earnings are large enough so that the couple pays a marriage penalty. At that income, the wife's marginal rate drops down to the rate she faces on the single schedule on her income alone. Further increases in her income push her rate up the singles' marginal rate schedule until the rate reaches a plateau at the maximum 50 percent rate on earned income.

and what the rate would be if a credit were enacted. The second line of Table 4, for instance, shows that the primary worker in this example would experience an increase in marginal tax rate from 18 percent under current law to 19 percent under the credit. In the third line, the primary worker would actually experience a drop in his marginal rate--from 21 percent to 19 percent. Because the primary worker in the first line is from a couple that would get a credit of zero, his marginal rate would be unaffected. Primary workers' work decisions are less sensitive to marginal rate changes than are those of secondary workers. Therefore, if the credit caused a decrease in total hours worked by primary workers, the effect would probably be small compared to the increase in hours worked by secondary workers.[10]

10. The model that Hausman used to estimate the responses of primary and secondary workers to a 10 percent rate cut could be adapted to produce labor supply responses to the marriage credit, but as yet this has not been done.

CHAPTER IV. CONCLUSION

Concern about the marriage tax penalty has generally been focused either on tax equity or on the labor force participation of married women or both. Those concerned with tax equity are bothered by the fact that many people pay more tax if they marry than they would if they did not marry. Some also feel that the tax system should not encourage divorce (or encourage people to live together without marrying). Tables 1 and 2 show that the problem of large marriage penalties for most working couples will persist over the next few years if only the Administration's 30 percent across-the-board rate reduction is enacted. Although the Administration's rate cut would generally reduce marriage penalties, the penalties could be reduced further if part of the individual tax cut were devoted specifically to that purpose. The proposed 10 percent deduction for two-earner couples would greatly lessen marriage penalties, but would not eliminate them. The marriage tax credit (in a somewhat different form that that introduced in the Congress) would come closer to eliminating marriage penalties than would the Administration's rate cuts by themselves or the deduction for two-earner couples.

Those concerned with the labor force participation of married women are bothered by the very high average and marginal tax rates for many married women whose working decisions are influenced by tax rates far more than are the decisions of primary workers. Tax rates facing secondary workers would be reduced 5 percent by a 5 percent rate cut, 30 percent by a 30 percent rate cut, and 10 percent by a 10 percent two-earner deduction. A marriage tax credit would reduce average and marginal tax rates for most secondary workers, but the percentage reductions would vary.

Tax rates facing primary workers would be reduced 5 percent by a 5 percent rate cut, 30 percent by a 30 percent rate cut, but would not be changed by a 10 percent two-earner deduction, and would actually be increased in some cases by a marriage tax credit. Although the hours worked by married women would increase as a result of any of the proposals, overall hours worked by married men and women would increase more if a portion of the tax cut was targeted on marriage penalty reduction rather than if the whole tax cut was devoted to an across-the-board rate reduction with the same revenue loss.

None of the targeted proposals to reduce marriage penalties is likely to provide a lasting solution that will please all taxpayers. The proposals simplest to administer would do the least precise job of offsetting marriage penalties and often would create larger marriage bonuses (and hence larger single penalties) . In addition, people who believe that the family should be the basic unit of taxation are often critical of these targeted proposals since they produce a situation in which married couples with equal incomes would pay different amounts of tax. (At any combined income level, couples whose income is divided most evenly between husband and wife would pay the least tax.) Ultimately, perfect marriage neutrality can only be achieved by changing to a proportional tax (or a progressive flat-rate tax with personal exemptions) or by taxing individuals rather than families.

APPENDIXES

APPENDIX A. EXPLANATION OF MUTUAL INCONSISTENCY OF THE THREE CONCEPTS OF TAX EQUITY

The following explanation is excerpted from Jane Bryant Quinn, "The Marriage Penalty," Newsweek (August 28, 1978), p. 72.[1]

An equitable tax system, Harvey S. Rosen of Princeton University observes, is generally expected to meet three tests: (1) the tax should be progressive, taxing a person's first dollar of income at a lower rate than the extra dollars he piles on top; (2) your tax burden shouldn't be changed by marital status; (3) other things being equal, families with the same incomes should pay the same tax. Any two of these goals can be achieved at the same time, Rosen says, but not all three. As long as we accept progressivity, we have to choose either point 2 or point 3 but not both.

Clash of Principles

This calls for an example. First take point 2, that marital status shouldn't make any difference to your tax. Under this principle, each person's income would be taxed individually, and at the same rate. A person with a $20,000 taxable income would owe the same amount, whether married or single. But look at what this does to family income: a $20,000, single-earner family is in a higher tax bracket than a family where the man makes $15,000 and the wife $5,000. The latter, in turn, pays more than the family where each makes $10,000. That's three different $20,000 families, each paying a different tax. A clear violation of point 3.

Now let's explore point 3, that all families with the same income should pay the same level of tax. Couples with taxable incomes of $20,000 owe the same amount, regardless of who earns what; similarly, single-person households with $20,000 would pay

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at the same rate as marrieds (although they would normally have fewer exemptions). This contradicts point 2. Working couples would pay less if they stayed single.

Prior to the Tax Reform Act of 1969 there was no marriage penalty. When a working couple married and filed a joint return, their combined tax was generally the same before and after marriage. Point 2 triumphant, but point 3 up the creek. A single person paid up to 41 percent more than a married person with the same income.

This tremendous inequity was eased by Congress in 1969. The tax advantage of joint filing was reduced, so that the extra tax paid by singles wouldn't rise more than 20 percent above the married amount. The change in rates created a marriage penalty for working couples--not intentionally, but as an arithmetical by-product of a progressive-tax system.

Spreading the Grief

The present law is actually fairer than the old one, despite the marriage penalty, because it spreads the grief around. In the old days, only singles paid an excess tax. Today, singles still pay at a higher rate than marrieds, but the differential isn't as high. Working couples pay a marriage penalty. Only traditional, single-earner families (or families where one earner makes very little) come out relatively ahead.

MATHEMATICAL EXPLANATION[2]

The logical inconsistency 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,

$$T(C) \neq T(A) + T(B). \qquad (1)$$

2. Reprinted from The Income Tax Treatment of Married Couples and Single Persons, prepared by the Joint Committee on Taxation for the House Committee on Ways and Means and the Senate Finance Committee, 96:2 (1980), p. 26, footnote 1.

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

$$T(AB) - T(CD), \tag{2}$$

and marriage neutrality requires both that

$$T(A) + T(B) - T(AB) \tag{3}$$

and that

$$T(CD) = T(C). \tag{4}$$

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

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

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

APPENDIX B. MARRIAGE PENALTIES UNDER CURRENT LAW AND AFTER ENACTMENT OF 10 PERCENT DEDUCTIONS WITH VARIOUS FLOORS AND CAPS FOR TWO-EARNER MARRIED COUPLES

APPENDIX B. MARRIAGE PENALTIES* UNDER CURRENT LAW AND AFTER ENACTMENT OF 10 PERCENT DEDUCTIONS WITH VARIOUS FLOORS AND CAPS[b] FOR TWO-EARNER MARRIED COUPLES FOR CALENDAR YEAR 1981 (In dollars)

Combined Adjusted Gross Income	Current Law Penalty	No Floor; $2,500 Cap	No Floor; $3,500 Cap	No Floor; $5,000 Cap	No Floor; No Cap	$2,000 Floor; No Cap	$3,000 Floor; No Cap	H.R. 177[c]
15,000 Income split								
90/10	-145	-177	-177	-177	177	-145	-145	-145
80/20	124	61	61	61	61	103	124	61
67/33	197	93	93	93	93	135	156	93
50/50	240	83	83	83	83	125	146	83
25,000 Income split								
90/10	-311	-331	-331	-381	-381	-325	-311	-311
80/20	34	-104	-104	-104	-104	-50	-22	-104
67/33	168	-48	-48	-48	-48	0	24	-48
50/50	229	-89	-89	-89	-89	-41	-17	-89
30,000 Income split								
90/10	-411	-495	-495	-495	-495	-439	-411	-411
80/20	-47	-215	-215	-215	-215	-159	-131	-215
67/33	183	-94	-94	-94	-94	-38	-10	-94
50/50	383	-37	-37	-37	-37	19	47	-37
40,000 Income split								
90/10	-577	-725	-725	-725	-725	-651	-614	-577
80/20	-54	-350	-350	-350	-350	-276	-239	-350
67/33	502	14	14	14	14	88	125	14
50/50	822	82	82	82	82	156	193	82
50,000 Income split								
90/10	-740	-955	-955	-955	-955	-869	-826	-740
80/20	120	-310	-310	-310	-310	-224	-181	-310
67/33	1,068	358	358	358	358	444	487	358
50/50	1,455	380	380	380	380	466	509	595
60,000 Income split								
90/10	-902	-1,196	-1,196	-1,196	-1,196	-1,098	-1,049	-902
80/20	297	-291	-291	-291	-291	-193	-144	-291
67/33	1,579	620	620	620	620	707	756	620
50/50	2,166	983	768	768	768	854	897	1,198
100,000 Income split								
90/10	-241	-741	-741	-741	-741	-641	-591	-241
80/20	1,671	671	671	671	671	771	821	671
67/33	3,172	1,922	1,522	1,522	1,522	1,622	1,672	2,172
50/50	3,760	2,510	2,010	1,260	1,260	1,360	1,410	2,760

(Continued)

APPENDIX B. **(Continued)**

a. The marriage penalty is the difference between the tax the couple pays married filing jointly compared to the sum of what the spouses would pay if single. A minus (-) sign indicates a marriage bonus, that is, a married couple pays less than if they were single. Couples have no investment income or dependents. Itemized deductions are 23 percent of adjusted gross income. If this is less than the zero bracket amount, they are assumed not to itemize.

b. A deduction of 10 percent of the earnings of the lesser-earning spouse exceeding the floor, up to a maximum deduction equal to the cap. Under a 10 percent deduction with a $2,000 floor and $5,000 cap, for instance, a couple in which one spouse earned $40,000 and the other earned $60,000 would be allowed a deduction of $3,800 [$3,800 - .10($40,000-$2,000)]. A couple in which both spouses earned $60,000 would be allowed the maximum deduction of $5,000, since .10($60,000-$2,000) - $5,800, which exceeds the $5,000 cap.

c. A 10 percent deduction would be allowed for couples in which each spouse contributed at least 20 percent of the combined earnings. The maximum would be $2,000.

APPENDIX C. SAMPLE TABLE TO DETERMINE MARRIED EARNERS' CREDIT

APPENDIX C. SAMPLE TABLE TO DETERMINE MARRIED EARNERS' CREDIT

Earned Income of Spouse No. 2 (In thousands of dollars)	Earned Income of Spouse No. 1 (In thousands of dollars)										
	0	5	10	15	20	25	30	35	40	45	50
0	0	0	0	0	0	0	0	0	0	0	0
5	0	186	198	170	0	0	0	0	0	0	0
10	0	198	351	515	591	622	637	627	454	439	389
15	0	170	515	843	1,128	1,394	1,619	1,681	1,736	1,721	1,691
20	0	0	591	1,128	1,626	2,052	2,349	2,639	2,694	2,699	2,699
25	0	0	622	1,394	2,052	2,549	3,074	3,364	3,439	3,474	3,474
30	0	0	637	1,619	2,349	3,074	3,564	3,874	3,979	4,014	4,014
35	0	0	627	1,681	2,639	3,364	3,874	4,174	4,279	4,314	4,314
40	0	0	454	1,736	2,694	3,439	3,979	4,279	4,334	4,369	4,369
45	0	0	439	1,721	2,699	3,474	4,014	4,314	4,369	4,394	4,394
50	0	0	389	1,691	2,699	3,474	4,014	4,314	4,369	4,394	4,394

a. This table is from S.775, introduced by Senator Moynihan. The credit is the amount of marriage penalty a couple with one child would experience if they had no investment income and did not itemize deductions. Couples who would, under these assumptions, currently have a marriage bonus would get a credit of zero.