

Policy Watch

The Marriage Penalty

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This feature contains short articles on topics that are currently on the agendas of policymakers, thus illustrating the role of economic analysis in illuminating current debates. Suggestions for future columns and comments on past ones should be sent to C. Eugene Steuerle, c/o *Journal of Economic Perspectives*, The Urban Institute, 2100 M Street NW, Washington, D.C. 20037.

Introduction

Many government programs have implicit penalties or subsidies for marriage. Indeed, the U.S. General Accounting Office (1996) has identified 1049 federal laws in which marital status is a factor, ranging from income tax and welfare provisions to programs involving veteran's payments, immigrant benefits, and other social insurance. In recent years, a rise in the number of dual earner couples and a narrowing in the earnings gender gap have heightened the impact of, and the interest in, the marriage penalty. In this article we discuss the marriage penalty, with a particular focus on tax and transfer programs. Why does it exist? Who faces it? To what extent does it affect marriage and labor market behavior? What tradeoffs are involved in reducing it?

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Why Does the Marriage Penalty Exist?

A marriage “penalty” or “subsidy” occurs when a change in marital status generates a change, negative or positive, in disposable income. In general, any tax or transfer program can create a marriage penalty or subsidy if two conditions are satisfied: the program imposes taxes or gives subsidies that are based on household income or wealth; and the program imposes different marginal tax rates at different levels of income or wealth (Steuerle, 1999).

The federal individual income tax system, for example, has a progressive marginal tax rate structure with features that vary by legal marital status. To illustrate the marriage penalty in the income tax, consider two individuals, each with adjusted gross income (AGI) of \$40,000 in 1998. If each files as a single taxpayer using the standard deduction for singles of \$4250 and the personal exemption of \$2700, then each pays income taxes of \$5958, for a combined tax liability of \$11,916. Suppose now that these individuals marry. Combining their income and using the married standard deduction of \$7100 and two personal exemptions of \$2700 each, their taxes as a married couple filing jointly are \$13,394, which is \$1478 more than they paid as two single taxpayers.¹ To illustrate instead a marriage *subsidy*, consider two other individuals, one with an income of \$80,000 and the other with zero income. As a married couple, their taxes are the same \$13,394 as the first couple, while their combined taxes as singles are \$17,508. This couple pays \$4114 *less* in income taxes as married than as singles. Of course, there are countless possibilities for tax penalties or subsidies, depending upon the level and the split of income between individuals, as illustrated for various other hypothetical couples in Table 1.

At the lower end of the income scale, the Earned Income Tax Credit (EITC) is an important source of marriage non-neutrality in the income tax. The EITC subsidizes the earnings of low-income, working families. Eligibility is based on labor income but the credit is phased out at higher levels of income. The EITC is refundable (if a filing unit’s credit is greater than its tax liability, then the Treasury pays the difference to the filer) implying that even those tax units with low or zero tax liability are eligible. The most generous EITCs are available to families with at least one dependent, although childless individuals with very low incomes are eligible for small credits. The EITC may either penalize or subsidize marriage. A single mother with no earnings does not qualify for the EITC. If she marries a low-income spouse with earnings the family will now likely be eligible for the credit. In this case the EITC subsidizes marriage. However, if a single working mother

¹ Married couples may file taxes separately, using a different rate schedule than that used by married couples filing jointly. However, there is generally little gain from doing so, because the bracket widths for married individuals filing separately are exactly one-half of those for married couples filing jointly. For the example in the text, under separate filing each individual would have taxable income of \$33,750 (or \$40,000 less the personal exemption of \$2700 less one-half the married standard deduction of \$3550), and each would pay taxes of \$6697, for a combined tax liability of \$13,394, which is the same tax liability as on the joint return.

Table 1

Marriage Penalties and Subsidies for Hypothetical Couples, 1998^a

| <i>AGI of Other Spouse</i> | <i>AGI of One Spouse</i> | | | | | | | |
|------------------------------------|--------------------------|---------------|---------------|---------------|---------------|----------------|----------------|----------------|
| | <i>0</i> | <i>20,000</i> | <i>40,000</i> | <i>60,000</i> | <i>80,000</i> | <i>100,000</i> | <i>150,000</i> | <i>200,000</i> |
| 0 | 0 | -833 | -1834 | -3764 | -4113 | -4713 | -6119 | -7197 |
| 20,000 | | 209 | -122 | -122 | -471 | -915 | -1800 | -1644 |
| 40,000 | | | 1477 | 1477 | 1284 | 1284 | 1477 | 1866 |
| 60,000 | | | | 1633 | 1884 | 1884 | 3388 | 3777 |
| 80,000 | | | | | 2135 | 2712 | 4950 | 5339 |
| 100,000 | | | | | | 3946 | 6261 | 7155 |
| 150,000 | | | | | | | 9082 | 10,664 |
| 200,000 | | | | | | | | 12,075 |

^a Italicized and positive numbers denote an increase in income taxes with marriage (a “marriage tax”), while bold and negative numbers denote a decrease in income taxes with marriage (a “marriage subsidy”). All calculations assume zero dependents and the use of the relevant standard deduction.

receiving the EITC marries a low-income spouse, the implicit tax rate on total family earnings is likely to leave the couple ineligible for the EITC, thereby penalizing marriage.

The patterns here are clear. When people with similar earnings marry, their combined income pushes them into higher tax brackets than they face as singles, and they pay correspondingly higher income taxes with marriage. Conversely, the marriage of two people with very dissimilar earnings means that the individual with higher income moves into a lower marginal tax bracket as a result of the marriage, thereby reducing the combined tax burdens of the two partners.

As the examples imply, the magnitude of the marriage tax or subsidy depends upon an array of specific tax features. The major factors are the rate schedules, the EITC, the standard deduction, the phase-out of the personal exemption, the limitation of itemized deductions, and certain other fixed dollar limitations (Congressional Budget Office, 1997). In total, there are 59 provisions in the individual income tax code that contribute to a marriage penalty or subsidy (U.S. General Accounting Office, 1996).²

The relative tax advantage of marriage has shifted as the income tax has changed over time (Bittker, 1975; Bartlett, 1998). Early in the history of the income tax, the unit of taxation was the individual, so taxes were largely unaffected by marriage. However, the Revenue Act of 1948 made the family the unit of taxation by instituting “income-splitting,” in which a couple’s tax liability is the same as the

² Many state income tax systems calculate tax liability as proportional to the federal income tax liability and therefore create marriage nonneutralities in the same way as the federal income tax. However, many states have provisions to mitigate a change in tax liability arising from marriage. Fifteen states have special joint rate schedules for reducing or eliminating the marriage penalty, ten states allow couples to file combined separate returns, and six states have flat tax rates. Eight states have no income tax and therefore no marriage penalty.

combined taxes of two individuals each with half of the couple's combined income. This change tended to give large subsidies to married couples. The introduction of a new rate schedule for single individuals in the Tax Reform Act of 1969 reversed that position, and instituted for the first time a tax penalty for many married couples. A variety of tax changes in the last three decades have markedly affected the potential for a marriage penalty or subsidy; for example, marginal tax rates dropped in the 1986 Tax Reform Act but have risen since then, a special deduction for secondary earners was instituted in 1981 and repealed in 1986, and the standard deductions have been raised and lowered.

Means-tested transfer programs also create marriage penalties and subsidies. Consider one of the largest of these programs, Temporary Aid to Needy Families (TANF), which provides cash to low-income families with dependent children and an absent, incapacitated, or unemployed parent. TANF eligibility is based on family living relationships rather than strictly on legal marital status. The program generally assumes that unrelated individuals do not contribute financially to the TANF unit, even if they are cohabiting with the head-of-household (Moffitt, Reville and Winkler, 1998). Related partners—either the natural father of the children or the legal spouse of the mother—are assumed to contribute to the household. These features result in some seemingly inconsistent TANF grant penalties due to marriage. For example, if a single mother marries the father of her children and he was not previously living in her household, then she will likely lose some or all of her TANF grant, thereby incurring a marriage penalty.³ Similarly, if a single mother marries someone unrelated to her children, then her TANF grant may be reduced to reflect the income of the new spouse, regardless of their previous living arrangements. However, if a single mother is already cohabiting with the father and then marries him, she does not lose TANF funds because his income had already been considered part of the family's resources. The size of the TANF marriage penalties varies greatly by state because states vary in the generosity of their benefits.

To illustrate a marriage penalty from income transfers, suppose that a single woman living in Pennsylvania (a state with TANF benefits of median generosity) in 1998 with two children and zero earnings receives the maximum of \$3756 per year in food stamps and \$5052 in TANF benefits. Suppose further that the father of the children lives alone, has \$15,000 annual earned income, and does not support his children. If the father marries the mother, then the TANF and food stamp programs include his income. The family is no longer categorically eligible for TANF because the children are not deprived of parental support, and with the inclusion of the father's earned income, the annual food stamp benefit for the family of four falls to \$2715. This family experiences a marriage transfer penalty of \$6093 (or \$5052 from TANF plus \$1041 from food stamps). However, this family also has a somewhat offsetting marriage subsidy on the tax side. Before marriage,

³ The exception to this is the provision in TANF that provides benefits to two-parent families in which the primary wage earner is unemployed (previously called AFDC-UP). In this case, marriage to an unemployed man may actually increase benefits because benefits rise with family size.

Table 2

Marriage and Cohabitation Penalties and Subsidies for Low-income Hypothetical Couples, 1998^a

| | <i>Dissimilar Incomes: Woman with \$0 and Man with \$15,000 Earnings</i> | | | | <i>Similar Incomes: Woman with \$10,000 and Man with \$15,000 Earnings</i> | |
|--|--|--------------|----------------------------|--------------|--|--------------|
| | <i>Father</i> | | <i>Unrelated Male</i> | | <i>Father</i> | |
| | <i>Cohabit^b</i> | <i>Marry</i> | <i>Cohabit^c</i> | <i>Marry</i> | <i>Cohabit</i> | <i>Marry</i> |
| Total Penalty | \$ 1809 | \$ 1711 | \$1041 | \$ 1711 | \$ 2764 | \$ 5379 |
| Total Penalty as Percent of Joint Pre-tax Income | 12.1 % | 11.4 % | 6.9 % | 11.4 % | 11.4 % | 21.5 % |
| Source of Penalty: | | | | | | |
| Federal Income Tax (excluding the EITC) | -1110 | -1208 | 0 | -1208 | -652 | -143 |
| EITC | -3174 | -3174 | 0 | -3174 | 582 | 2688 |
| TANF | 5052 | 5052 | 0 | 5052 | 0 | 0 |
| Food Stamps | 1041 | 1041 | 1041 | 1041 | 2834 | 2834 |

^a Italicized and positive numbers denote an increase in income tax liability or a decrease in transfer benefits (a "marriage penalty"), while bold and negative numbers denote a decrease in income tax liability or an increase in transfer benefits (a "marriage subsidy"). All calculations assume two dependents, the use of the relevant standard deduction, and Pennsylvania residency. The changes arising from cohabitation or marriage assume that the couple was not living together prior to the cohabitation or marriage.

^b When cohabiting, the man is assumed to file as head of household, and the woman is assumed to file a single tax return.

^c The woman is assumed to file as head of household, and the cohabiting male is assumed to provide less than half of the support for children (otherwise this is the same case as if the male is the father). Note that the food stamp unit is the household, so the man's income is counted against the food stamp grant.

the father's federal tax liability is \$1208 (assuming that he takes the standard deduction and one exemption), and the mother has no tax liability. After marriage, the combined tax liability of the family falls to \$0, and they are also eligible for \$3174 from the EITC. This marriage subsidy of \$4382 from both features of the income tax mitigates a substantial portion of the transfer penalty, even though the family still faces on balance a penalty of \$1711.

Generally, the pattern of large penalties in the transfer system and large subsidies in the tax system for low-income couples with dissimilar incomes holds when the mother marries either the natural father or an unrelated male. Also, cohabiting with the father of the children typically generates nonneutralities, but cohabiting with an unrelated individual does not. Table 2 shows the combined tax/transfer penalties for various hypothetical low-income families.

It is important to note that penalizing or subsidizing marriage was rarely the explicit intent of policymakers, in either the tax or transfer system. Most marriage penalties and subsidies have emerged somewhat accidentally, because of attempts

to meet other goals. In the income tax, the combination of progressive tax rates and a structure in which families with identical total income and family structure pay equal taxes (regardless of whether the income is earned by one worker or two) inevitably generates marriage nonneutrality. Similarly, the marriage penalty is not designed as part of the TANF, but rather arises from attempts to be well-targeted.

Who Faces Marriage Penalties and Subsidies?

A number of recent studies have attempted to calculate the marriage penalty or subsidy in the individual income tax (Rosen, 1987; Brozovsky and Cataldo, 1994; Feenberg and Rosen, 1995; Alm and Whittington, 1996a; Congressional Budget Office, 1997; Bull et al., 1998). One other study focuses on tax and transfer marriage penalties and subsidies for low-income households (Dickert-Conlin and Houser, 1998). Although the precise estimates of these studies differ, their broad outlines are the same.⁴

For the income tax, Alm and Whittington (1996a) calculate the marriage tax penalty and subsidy for a sample of married taxpayers from the Panel Study of Income Dynamics. As shown in Figure 1, their calculations indicate that there has been an average tax penalty whose magnitude over time has risen, fallen, and more recently risen, and in the last several years has averaged more than \$350 (in real 1994 dollars). Because on average married couples incur a tax penalty, the aggregate revenue gain in 1994 from the income tax was \$17–\$19 billion.

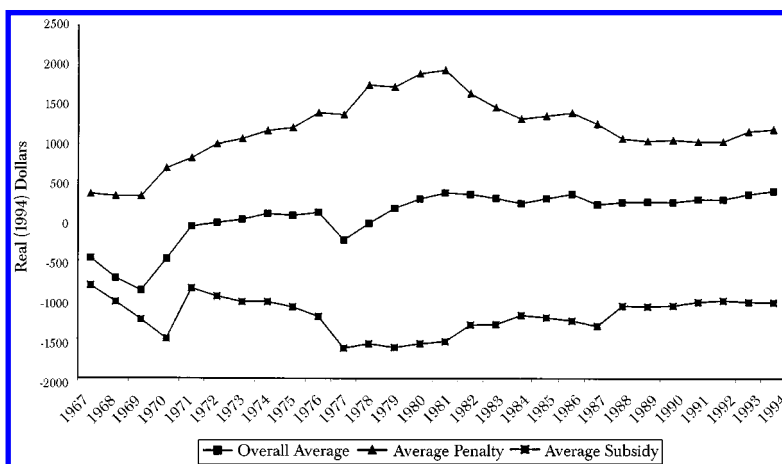
These averages conceal great variation. The percentage of families that pays a net penalty has risen since 1969, to nearly 60 percent in 1994, and for these families the average penalty in 1994 was roughly \$1200. The percentage of families receiving a net subsidy has fallen over time to 30 percent in 1994, and the average subsidy for this group was \$1100. These calculations are similar to the results of Feenberg and Rosen (1995) based upon tax return information, and to those of the Congressional Budget Office (1997), although the CBO estimates that a somewhat higher percentage of families receives a marriage subsidy (51 percent) and a lower percentage pays a tax (42 percent).

One reason that an increased proportion of families are facing a marriage penalty over the last few decades is an increase in income equality between spouses. Between 1969 and 1995 the proportion of working-age married couples with two workers increased from 48 percent to 72 percent (Congressional Budget Office, 1997). Over this same period, the fraction of working-age couples in which both husband and wife earned at least one-third of the couple's income increased to 34 percent from 17 percent.

Across the income distribution, the absolute size of the tax penalty or subsidy

⁴ For a detailed discussion of some of the difficulties of these studies, such as determining the individual tax liabilities of a married couple in the case of divorce, or establishing the impact of marriage on the tax liabilities of singles, see Alm and Whittington (1996a, 1999).

Figure 1

Average Tax Penalties and Subsidies, 1967–1994

is positively correlated with income (Alm and Whittington, 1996a). However, as a share of income, the penalties and subsidies are much larger for low-income families. The Congressional Budget Office (1997) estimates that in 1996 the average tax penalty for a family with less than \$20,000 in AGI is 7.6 percent, compared to 1.6 percent for families with AGI greater than \$50,000.

The marriage penalties and subsidies borne by low-income households due to the combined effects of transfers and income taxes are less well-documented. For a sample of low-income families with children from the Survey of Income and Program Participation, Dickert-Conlin and Houser (1998) calculate the 1990 marriage penalty/subsidy implicit in Aid to Families with Dependent Children (the predecessor to TANF), food stamps, Supplemental Security Income, and federal and state income taxes. They find that families paying the largest marriage penalties in the *transfer* system generally receive the largest marriage subsidies in the *tax* system, as in the example presented earlier. In particular, they find that 74.2 percent of poor married couples with children face a marriage penalty in the transfer system and a simultaneous subsidy in the tax system, with an average net marriage penalty of 23.4 percent of their income.

What are the Behavioral Effects from Marriage Penalties and Subsidies?

Extensions of the standard economic theory of marriage (Becker, 1991) predict that an increase in the marriage penalty will reduce the likelihood of

individuals choosing to get or stay married, but how do individuals actually react?⁵ Alm and Whittington (1995) find that the aggregate marriage rate in the United States falls as the average tax penalty increases. Using individual longitudinal data from the Panel Study of Income Dynamics, Alm and Whittington (1999) further find that probability of marriage falls as the marriage penalty increases; at the mean values of the variables a 10 percent rise in the marriage penalty leads to a 2.3 percent reduction in the possibility of first marriage, while at the level of the maximum tax penalty a 10 percent rise in the marriage penalty leads to a 12.5 percent fall in the probability of first marriage. There is also evidence that the marriage penalty affects the probability of divorce, especially for women (Whittington and Alm, 1997) and low-income individuals (Dickert-Conlin, 1999).

The marriage penalty may also affect the timing of the marriage decision. Several studies have found that couples in the United States (Sjoquist and Walker, 1995), as well as in Canada, England, and Wales (Gelardi, 1996), have timed their marriages to avoid one year of the tax penalty. The magnitude of these affects appears to be quite small; one estimate finds that doubling the tax penalty increases the probability that a couple delays its marriage to the next tax year by 1 percent (Alm and Whittington, 1996b). There is little evidence that the tax penalty/subsidy affects the timing of divorce (Alm and Whittington, 1996b).

There is also much research on the effect of the transfer system on marriage decisions, but the results here are inconclusive. Empirical studies conducted in the 1980s, reviewed by Moffitt (1992), consistently found that welfare exerted a small, positive, and significant effect on the likelihood that a household would be headed by an unmarried woman. However, more recent studies that control for unobserved state characteristics by using a fixed effects model have found that welfare benefits are insignificantly related to whether a family is headed by an unmarried woman (Moffitt, 1994; Hoynes, 1997).

Marriage penalties and subsidies may also affect the labor supply decisions of married individuals.⁶ For example, consider an individual who is not currently working (the “secondary earner” of the family) and who has a spouse who is working (the “primary earner”). If the secondary earner decides to work, then the additional income is taxed at the marginal tax rate faced by the family on its combined income, and this tax rate is likely to be much higher than the tax rate that the individual would face if single. The marriage penalty thus discourages both labor force participation and hours worked of the secondary earner.

Recent estimates of labor supply elasticities indicate that female labor force participation is especially responsive to marginal tax rates, particularly for women

⁵ One important issue in this empirical work is identification of the impact of taxes or transfers on marital status, separately from the effect of income on these decisions. In the tax literature, the separate tax and income effects are identified by variation in the relative incomes of the spouses and by statutory changes in the tax code over time. The separate tax and income effects in the welfare literature are identified by cross-state variation in welfare benefits.

⁶ There is a large literature on the impact of the individual income tax on labor supply decisions. See MaCurdy, Green and Paarsch (1990) for a survey.

in high-income couples (Triest, 1990; Eissa, 1996). A study of the secondary earner deduction of the early 1980s found that it increased the probability that a married women worked outside the home, and that the effect increased with the value of the deduction and spousal income (Leuthold, 1985). Several studies of the EITC have found that the phase-out range of the credit, which increases the effective marginal tax rate faced by workers, is likely to decrease the hours worked and the labor force participation of secondary workers (Dickert, Houser and Scholz, 1995; Eissa and Hoynes, 1998). Because welfare programs typically target single-parent families, they usually offer little basis for investigating the effect on labor supply of secondary earners. One exception was the AFDC-UP program, in which eligibility was based on the presence of low family income and an unemployed primary earner. Hoynes (1996) finds that the high implicit tax rates facing AFDC participants significantly reduce labor supply, both for wives and husbands.

Although recent research demonstrates that marriage penalties and subsidies distort at least some individual decisions, a number of unanswered questions remain about behavioral effects. The precise correlation between welfare and marriage remains an unresolved empirical question. As the United States shifts support for the poor toward time-limited welfare and the EITC, the effects of these changes on incentives for marriage are an important subject for research. The extent to which the marriage penalty affects a couple's choice to cohabit rather than to marry is not known. The behavioral effects of penalties in other tax and transfer systems have not been investigated. For example, responses to potential marriage penalties in Social Security are an area where research is lacking.

What are the Tradeoffs in Reducing the Marriage Penalty?

It seems uncontroversial that the marriage penalty is an undesirable feature of tax and transfer systems, at least when considered in isolation, and there are numerous proposals before Congress to reduce or eliminate the income tax marriage penalty (listed in Table 3). Marriage penalties and subsidies distort marital and labor supply decisions, thereby creating excess burdens. Large marriage penalties may lessen respect for laws, which can in turn contribute to a host of illegal and undesirable behaviors (Steuerle, 1997). Marriage penalties can also weaken the family as a basic societal institution, a development that may well be associated with a wide range of societal ills.

Recent changes in family structure further reinforce the arguments for reforming the marriage penalty. Recall that the marriage penalty arises in large part because the family is the legal unit for paying taxes or receiving transfers. However, there is an incredible diversity in family structure. Two-earner couples are now more common than single-earner couples, but equal income for such couples does not imply equal ability-to-pay; in fact, it is typically thought that a single-earner couple has a greater ability to pay than a two-earner couple because the non-working spouse provides household services that are not taxed. Further,

Table 3

Marriage Tax Relief Legislation Proposed in the 106th Congress, Grouped by the Type of Change Proposed^a

| <i>Main Features of Proposed Legislation</i> | <i>Bills</i> | <i>Sponsor</i> |
|---|--------------------------------------|--|
| The standard deduction for married couples filing jointly is increased to double the standard deduction for single taxpayers. | S.284.IS H.R.108.IH H.R.725.IH | Sen. McCain (R-AZ) Rep. Knollenberg (R-MI) Rep. Kleczka (D-WI) |
| The tax brackets for married couples filing jointly are increased to double the brackets of single taxpayers. | H.R.767.IH H.R.6.IH | Rep. Thune (R-SD) Rep. Weller (R-IL) |
| The standard deduction for married couples filing jointly is increased to double the standard deduction for single taxpayers, and the tax brackets for married couples filing jointly are increased to double the brackets of single taxpayers. | S.12.IS | Sen. Hutchinson (R-TX) |
| Income splitting and separate filing for married couples are allowed. | S.15.IS | Sen. Hutchinson (R-TX) |
| A deduction for two-earner married couples is allowed, specified as a percentage of the earned income of the spouse with lower earnings. | S.8.IS | Sen. Daschle (D-SD) |

^a This legislation is as of March 15, 1999.

cohabitation among opposite and same-sex couples, as well as other nonmarital joint living arrangements that are not based on legal marital status, has become common. Treating these households differently than married households with equal ability-to-pay, as current law requires, suggests that there is no resource sharing within them, which is a dubious proposition.

Issues raised by marriage penalties and subsidies are not unique to the United States. Indeed, there is no uniform treatment of marriage in the tax systems of industrialized countries. However, there has been a trend in OECD countries away from joint taxation, such as exists in the United States, and toward individual taxation (Pechman and Englehardt, 1990; Organization for Economic Cooperation and Development, 1991).

Achieving marriage neutrality requires eliminating either of the two conditions that generate a marriage penalty or subsidy: imposing taxes or giving transfers based on household resources, and imposing them at different marginal tax rates. Within the existing tax structure, one piecemeal approach would exempt from taxes some amount of income of the secondary earner of the couple, recreating the "secondary earner deduction" that existed for a time in the 1980s. Another piecemeal approach would widen the brackets and increase the standard deduction for joint filers. More radical approaches would eliminate the progressive tax rate structure, replace the income tax with a national consumption tax, or even restore the individual as the unit of taxation. Similar reforms are possible in the transfer

system, especially changes that would introduce a proportional rate structure or that would make the individual the unit, instead of the family. For analysis of proposals along these lines, see the Congressional Budget Office (1997), Lav and Berube (1998), and Steuerle (1998).

The appropriate course of action is clouded by the many goals embedded in the tax and transfer systems: raising revenue, providing support to low-income families, minimizing work and marriage disincentives, reducing compliance and administrative costs, treating like families equally, maintaining progressivity, strengthening the family, and so on. Inevitably, meeting these goals requires facing tradeoffs. Allowing married taxpayers the choice of filing as individuals would eliminate the marriage penalty, but likely would reduce government revenues and increase compliance and administrative costs. Redefining the individual as the unit for paying taxes or receiving subsidies would eliminate penalties and subsidies, but would also compromise the goal of providing support to low-income families, rather than low-income individuals. Flattening the tax and transfer rate structure would reduce marriage penalties and subsidies, but would also reduce progressivity.

Reducing the marriage penalty requires facing these sorts of tradeoffs openly and honestly. Still, there are compelling reasons that now may be an appropriate time to move the tax and transfer systems closer to marriage neutrality.

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