CBO TESTIMONY

Statement of
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on
Marriage and the Federal Income Tax

before the
Committee on Ways and Means
U.S. House of Representatives

February 4, 1998

NOTICE

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Mr. Chairman and members of the Committee, thank you for inviting me to testify on the issue of marriage penalties and bonuses. As you know, the Congressional Budget Office (CBO) published a study of marriage and the federal income tax last summer. This morning I will summarize the highlights of that study.

The current U.S. tax system is not marriage neutral. More than 20 million married couples pay higher taxes than they would if they were single, giving rise to a marriage penalty. However, another 25 million couples get a marriage bonus; that is, their taxes are lower as a consequence of marriage. In recent years, a growing number of married couples have incurred marriage penalties, raising questions of fairness. But it is also important to consider other issues, such as the disincentive to work, that arise from the tax treatment of families and individuals. Incentives to marry may also be affected.

Marriage penalties and bonuses are by-products of attempts by the Congress to balance the tax treatment of families and individuals while preserving other desired features of the tax system. On the one hand, the tax code seeks to levy the same tax on couples with the same income. On the other hand, it tries to minimize the effect of marriage on a couple's tax liability. A tax structure with progressive rates cannot attain both goals, however. The incompatibility of progressive rates, equal treatment of married couples, and marriage neutrality results in a continuing tension within the tax code.

Since 1948, when individual filing was replaced with joint taxation for married couples, the goal of marriage neutrality has been sacrificed to the principle that couples with the same combined dollar income should pay the same total tax, regardless of the division of earnings between spouses. For instance, the tax liability of a married couple with an annual income of $60,000 would be the same whether that income was earned entirely by one person or by a husband and wife each making $30,000. Many people would argue that such an outcome is eminently fair. But others would argue that money income may be a poor reflection of ability to pay when comparing one-earner and two-earner couples. The real income of one-earner couples is often enhanced by services provided in the home by the spouse with no market earnings, whereas two-earner couples bear additional costs that reduce their real incomes.

The conflict among inconsistent goals that has given rise to marriage penalties and bonuses also makes devising acceptable legislative remedies difficult. Although many approaches could reduce or eliminate marriage penalties, most would have significant revenue costs, would increase bonuses as well as reduce penalties, and would add significant complexity to the tax code. In addition, some approaches would change tax rates more than others and thus have greater effects on couples' work behavior.

MARRIAGE PENALTIES AND BONUSES IN THE CURRENT TAX SYSTEM

CBO estimates that in 1996, just over half of all married couples received marriage bonuses, saving them $1,300 per couple on average. At the same time, a little more than 40 percent of couples incurred penalties, averaging $1,380 per couple. Increases in married women's work participation and earnings over the past two decades have increased the fraction of couples paying penalties as well as the average size of those penalties. Penalties affect two disparate sets of taxpayers for different reasons. At the middle and top of the income distribution, the progressivity of the tax structure—tax rate brackets and limits on credits and deductions—causes most penalties. For low-income couples, however, the earned income tax credit (EITC) generates most penalties.

Marriage penalties and bonuses also exist outside the federal income tax, because benefits from transfer programs such as Social Security and Food Stamps depend on marital status and family income. However, my testimony today addresses only the different income taxes paid by joint and individual filers.

A Legislative History of Marriage Penalties and Bonuses

Marriage penalties and bonuses did not arise through explicit legislation. Instead, they were created by Congressional action intended to change the relative tax burdens borne by couples and single people. At its inception in 1913, and for the next 35 years, the federal income tax was levied on individuals, so marriage had no effect on tax liabilities. Individual filing remains the practice in most other industrialized countries. In the United States, however, following the rapid expansion of the income tax during World War II, some states enacted community-property legislation to enable couples to split their income and thus pay lower federal income taxes. In response, the Congress in 1948 codified income-splitting for all couples in the form of joint filing. Under that status, most married couples paid lower taxes than they would if they were single, and marriage bonuses were born. However, single taxpayers viewed joint filing not as a bonus for couples but rather as a "singles' penalty" that caused them to pay higher taxes than they would if they were married. Under pressure from those taxpayers, the Congress in 1969 altered income tax brackets to limit "singles' penalties," lowering taxes on individual returns relative to those on joint returns. That action created marriage penalties for some couples while continuing marriage bonuses for others.

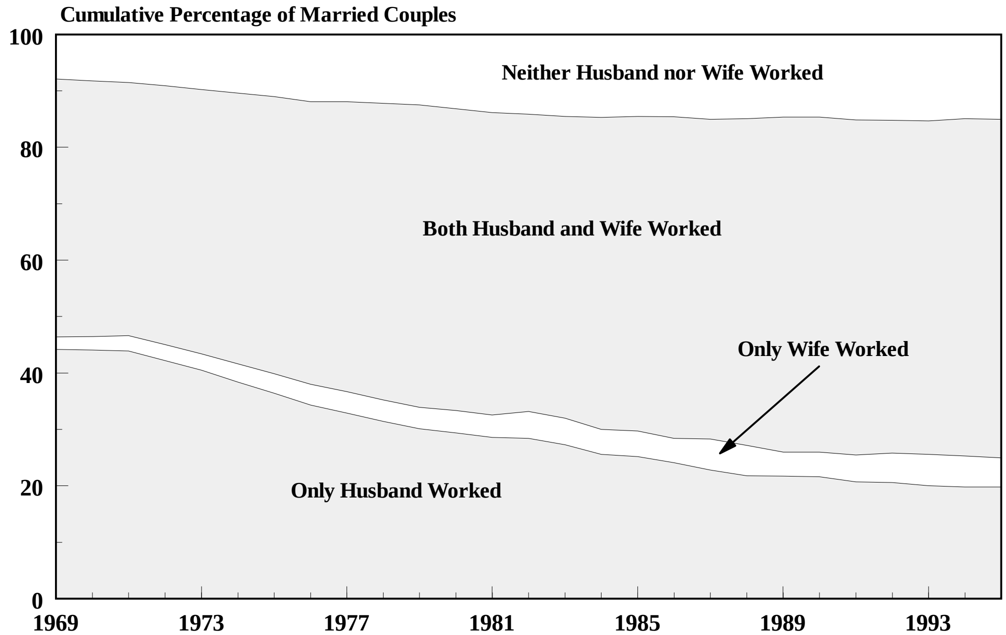
Subsequent tax legislation has altered the size of penalties and the couples they affect. The EITC, begun in 1975, provided tax relief for low-income working families with children. But it also created a new source of marriage penalties for those families. Subsequent increases in the credit have worsened its impact. In 1981, the Congress reduced marriage penalties by enacting the two-earner deduction, which allowed two-earner couples to deduct 10 percent of the earnings of the lower-earning spouse, up to $3,000. The Tax Reform Act of 1986 eliminated that provision, but at the same time it cut the number of tax brackets from 14 to two. That flattening of the tax rate structure sharply reduced the incidence and size of marriage penalties and bonuses. However, the addition of three rate brackets in 1990 and 1993 once again increased the size of both penalties and bonuses. Finally, the Taxpayer Relief Act of 1997 had the unintended result of creating additional marriage penalties and bonuses by phasing out eligibility for individual retirement arrangements and child and education credits over various income ranges. Analysts have identified more than 60 provisions in the current tax code that produce penalties and bonuses for married couples.

Besides those legislative actions, increases in the labor force participation and earnings of married women over the past 25 years have brought substantial shifts in the mix of taxpayers incurring penalties and receiving bonuses. Between 1969 and 1995, the fraction of working-age couples in which both spouses had paid employment increased by half, from 48 percent to 72 percent (see Figure 1). Over the same period, the incomes of husbands and wives in two-earner couples became more nearly equal. In 1969, 17 percent of two-earner couples had each spouse contributing at least one-third of total earnings; by 1995, that share had doubled to 34 percent (see Table 1). Those two changes—an increase in two-earner couples and greater equality of spouses' earnings—occurred for couples at all income levels, in all age categories, and regardless of whether they had children. Greater equality of earnings between spouses makes marriage penalties more likely and larger. As a result, the overall effect of those shifts in women's work participation and earnings has been to increase the number of couples incurring penalties and to boost the size of the average penalty.

The Distribution of Marriage Penalties and Bonuses

Whether a couple incurs a marriage penalty or receives a bonus depends on the division of earnings between the spouses and on the couple's total income. A couple with a $60,000 income earned equally by the husband and the wife would have a marriage penalty of $880—or about 1.5 percent of their income (see Box A-1 in the appendix for a calculation of the penalty). In contrast, if the couple's $60,000

FIGURE 1. WORK PATTERNS OF MARRIED COUPLES, 1969-1995



SOURCE: Congressional Budget Office tabulations of data from the Current Population Survey. Data limitations required interpolation of values for five years: 1970, 1972, 1974, 1975, and 1977.

TABLE 1. PERCENTAGE DISTRIBUTION OF WORKING-AGE MARRIED COUPLES BY DIVISION OF EARNINGS BETWEEN SPOUSES

	Each Spouse Earned at Least One-Third of Couple's Earnings	Both Spouses Had Earnings and One Spouse Contributed More Than Two-Thirds of Couple's Earnings	Only One Spouse Had Earnings	All Couples
1969	17.2	31.2	51.7	100.0
1979	22.2	37.4	40.4	100.0
1989	30.9	39.5	29.5	100.0
1995	33.9	37.9	28.2	100.0

SOURCE: Congressional Budget Office.

NOTE: Working-age married couples include only those in which both spouses are between ages 25 and 64, neither spouse has negative earnings, and at least one spouse has positive earnings.

income was earned entirely by one spouse, the couple would receive a bonus of $3,764—or 6.3 percent of their income (see Box A-2 in the appendix). In both cases, the penalty or bonus results from different tax brackets and standard deductions for single and joint filers. For low-income filers, the EITC causes the largest marriage penalties. For example, a couple with two children and each spouse earning $16,000 would incur a penalty of more than $4,000—or 13 percent of their income—almost all of which comes from the loss of the earned income credit when they file jointly (see Box A-3 in the appendix).

As those examples illustrate, couples with a more equal division of income between husband and wife are more likely to incur marriage penalties and less likely to receive bonuses than couples in which one spouse has significantly less income than the other or none at all. One-earner couples received seven-eighths of the total value of bonuses in 1996, although they represented just 44 percent of all couples (see Table 2). Their total net income tax liability was nearly $29 billion lower than if they had been required to file individual tax returns. By contrast, the 25 percent of couples in which both husband and wife earned at least one-third of the couple's income filed 52 percent of joint returns incurring marriage penalties, but only 2 percent of those receiving bonuses. As a result, those couples paid $15 billion more in taxes than they would have if they could have filed individually. Those estimates

TABLE 2. JOINT TAX RETURNS BY PENALTY OR BONUS STATUS AND SPOUSE'S SHARE OF EARNINGS, 1996

	Each Spouse Earned at Least One-Third of Couple's Earnings	Both Spouses Had Earnings and One Spouse Contributed More Than Two-Thirds of Couple's Earnings	Only One Spouse Had Earnings[a]	All Couples
Returns in Penalty or Bonus Category (Percent)				
With Penalties	52	48	0	100
Unaffected	21	5	75	100
With Bonuses	2	21	77	100
All Returns	25	31	44	100
Total Penalty or Bonus (Billions of dollars)				
Penalties	15.2	13.6	0	28.8
Bonuses	0.1	4.4	28.5	32.9
Net Effect on Tax Liability[b]	15.1	9.2	-28.5	-4.1

SOURCE: Congressional Budget Office.

NOTE: The numbers in this table are CBO projections.

a. Couples with no earners and those with one earner incur similar marriage penalties and bonuses and are thus combined in the analysis. For simplicity of exposition, the text refers to both types of couples as having one earner.

b. Positive values indicate net penalties; negative values indicate net bonuses.

are based on observed earnings under current tax law; they do not take account of the costs of couples altering their work and marriage patterns in response to the tax code.

The distribution of marriage penalties and bonuses varies markedly across the income distribution. Only 12 percent of couples with income below $20,000 had penalties in 1996, and 63 percent received bonuses (see Table 3). That situation occurs because only one-third of low-income couples have two earners. In contrast, more than three-fourths of couples with income above $20,000 have two earners. As a result, couples with income between $20,000 and $50,000 were somewhat more likely to receive bonuses than to incur penalties in 1996, whereas couples with income above $50,000 were somewhat more likely to incur penalties than to receive bonuses.

Measured as a percentage of income, marriage penalties and bonuses are largest for low-income families and smallest for high-income families (see Table 3). Couples with income below $20,000 who bear penalties are estimated to pay nearly 8 percent more of their income in taxes (measured at 1996 income levels) than they would if they could file individually. For their counterparts who received them, however, bonuses averaged 5 percent of income. Because bonus recipients in the under-$20,000 income category far outnumber people incurring penalties, low-income married couples received a total net bonus of $3 billion in 1996. For middle-income couples, both penalties and bonuses averaged roughly 3 percent of income. Slightly higher average penalties offset a slightly lower proportion of couples with

TABLE 3. DISTRIBUTION OF JOINT TAX RETURNS AND MARRIAGE PENALTIES OR BONUSES AS A PERCENTAGE OF ADJUSTED GROSS INCOME, 1996

	Income (In dollars)			
	Under 20,000	20,000-50,000	Over 50,000	All Incomes
Percentage of Returns in Income Category				
With Penalties	12	44	54	42
Unaffected	25	1	3	6
With Bonuses	63	55	44	51
All Returns	100	100	100	100
Penalty or Bonus as a Percentage of Adjusted Gross Income				
Penalties	7.6	3.2	1.6	2.0
Bonuses	5.0	2.6	2.0	2.3
Total Penalties and Bonuses (Billions of dollars)				
Penalties	0.9	9.6	18.3	28.8
Bonuses	3.9	8.7	20.3	32.9
Net Effect on Tax Liability[a]	-3.0	0.9	-2.0	-4.1

SOURCE: Congressional Budget Office.

NOTE: The numbers in this table are CBO projections.

a. Positive values indicate net penalties; negative values indicate net bonuses.

penalties, yielding a total net penalty for those couples of nearly $1 billion. Couples income couples, both penalties and bonuses averaged roughly 3 percent of income. with income over $50,000 received a total net bonus of $2 billion. Those couples with bonuses saved 2 percent of their income by filing jointly, more than offsetting the added taxes—equal to 1.6 percent of income—paid by couples with penalties.

WORK AND MARRIAGE DISINCENTIVES

Much of the current concern about marriage penalties revolves around the question of fairness—whether it is fair for two people to pay higher taxes just because they are married. The existence of penalties (and bonuses) is important for other reasons, however. Joint filing generally causes the lower-earning spouse to face a higher tax rate than he or she would on a single return. For example, a woman earning $10,000 in 1998 would incur a rate of 15 percent on taxable income of $3,050 if she was single. If she was married to a man earning $55,000, however, all of her income would be taxable at a 28 percent rate. Such higher tax rates may induce people—particularly second earners in couples—to choose not to work or to work fewer hours. Many empirical studies of labor market behavior have found that workers respond to changes in their after-tax wage rates, choosing to work less when their take-home wage rate falls. Such response to tax rates not only makes affected couples worse off, because their income is lower, but also reduces national output.

CBO estimates that because of marriage penalties, the total earnings of married couples are roughly 1 percent less than they otherwise would be.

Furthermore, the prospect of facing a tax increase of several hundred dollars may induce some couples to delay or forgo marriage. At the same time, marriage bonuses may induce other couples to marry to reduce their tax bills. Economic studies indicate that those effects are small but statistically significant. Those responses are further indications of the unintended effects of the income tax system.

OPTIONS FOR REDUCING OR ELIMINATING MARRIAGE PENALTIES

As evidenced by the hearings before this Committee, the changes in legislation and in women's labor market participation and earnings that have made marriage penalties larger and more common have brought renewed interest in reducing those penalties. The problem is difficult to fix, however, and satisfying every goal and everyone's perception of fairness is not possible. Furthermore, changes that reduce marriage penalties can have impacts beyond the immediate goals of the legislation.

A variety of options would reduce marriage penalties. One approach would involve making relatively minor alterations to the current tax code, such as changing tax brackets and standard deductions, restoring the two-earner deduction, or adding credits to offset penalties. More significant changes would allow couples to file either joint or single returns or would let couples split their income and pay taxes at individual rates. Finally, comprehensive tax reform—which would replace the current income tax with either a simpler tax on income or some form of consumption tax—could substantially reduce penalties and bonuses. Some pattern of penalties and bonuses would persist, however, unless individual filing was incorporated into the new system. Only a single-rate tax with no deductions could meet the twin goals of being marriage neutral and imposing the same tax on couples with the same income.

Changes in the tax code that reduce or eliminate marriage penalties face an inevitable trade-off: lower taxes for some couples entail either reduced federal tax revenues or higher taxes for other taxpayers. Revenue-neutral options necessarily redistribute taxes from people now incurring penalties to other taxpayers, either couples who now receive bonuses or single filers. Avoiding such redistribution could result in large revenue losses. At the same time, some options would lower marginal tax rates, thereby inducing some couples to work more and pay additional taxes that would offset the revenue losses. For example, restoring the two-earner deduction would lower marginal tax rates for second earners making less than $30,000 a year and might therefore be expected to increase the work effort of low-income couples.

All of the options that have been proposed in the Congress would reduce marriage penalties, but none would eliminate them. The reason is that none of the proposals would change the phaseout ranges for various deductions and credits, so those provisions would still impose penalties on some married couples. For example, unless the rules governing the EITC were altered, the major cause of penalties for low-income couples would continue to lead to higher taxes for couples with children. Other phaseouts, including those for the recently enacted child credit and the new education credits, would also be unaffected by proposed legislation.

In addition, proposals to reduce marriage penalties could raise the bonuses of couples already getting them. Restoring the two-earner deduction would reduce taxes for nearly all two-earner couples, regardless of whether they now incur penalties or get bonuses. Income-splitting would also increase bonuses by allowing couples to use individual tax rates. Those effects may be intended, but they widen the gap between the taxes paid by single people and those paid by couples. The result could be the same kind of demands for lower taxes from single people that led the Congress to create marriage penalties in the first place.

A final consideration regarding options to reduce marriage penalties is complexity. To varying degrees, most of the current proposals would further complicate a tax system that already befuddles many taxpayers. For example, allowing couples the choice of filing jointly or as two individuals would require them to complete three tax returns—the current joint return plus an individual return for each spouse—to determine which choice would benefit them more. Even the simplest proposals would necessitate some additional calculations, although the complications would be minimal.

CONCLUSION

A critical question in deciding whether and how to reduce marriage penalties involves which taxpayers gain and which lose. Any revenue-neutral action necessarily lowers taxes for some people at the cost of higher taxes for others. Even changes that only reduce the taxes for some people implicitly shift relative tax burdens to others whose taxes are not lowered. Despite the thorny issues raised, public discussion of the subject—such as this Committee's hearings provide—is helpful in identifying trade-offs within the tax system and the importance of such considerations in possible designs for fundamental tax reform.

APPENDIX:
EXAMPLES OF MARRIAGE PENALTIES AND BONUSES

BOX A-1.
A MARRIAGE PENALTY

A couple with $60,000 in total earnings split evenly between the husband and the wife will incur a marriage penalty of nearly $900 in 1998. The penalty results from two factors. First, the combined standard deduction for two individual tax filers is $8,500, $1,400 more than the standard deduction available on a joint return. At the couple's marginal tax rate of 28 percent, the lower deduction will increase the couple's tax liability by $392 (28 percent of $1,400). Second, because tax brackets for joint returns are less than twice as wide as those for individual returns, $3,750 that is taxed at 15 percent on individual returns will incur a 28 percent rate on a joint return. That higher tax rate will raise the couple's tax liability by an additional $488 (28 percent minus 15 percent equals 13 percent of $3,750). In combination, the two factors will increase the couple's tax liability by 1.5 percent of their adjusted gross income.

	Husband	Wife	Couple
Adjusted Gross Income	$30,000	$30,000	$60,000
Less personal exemptions	2,700	2,700	5,400
Less standard deduction	4,250	4,250	7,100
Equals taxable income	23,050	23,050	47,500
Taxable at 15 percent	23,050	23,050	42,350
Taxable at 28 percent	0	0	5,150
Tax Liability	3,458	3,458	7,795
		Marriage Penalty	$880
		As a Percentage of Adjusted Gross Income	1.5

SOURCE: Congressional Budget Office.

BOX A-2.
A MARRIAGE BONUS

A couple with $60,000 in total earnings all earned by the husband will receive a marriage bonus of nearly $4,000 in 1998. The bonus results from three factors. First, filing jointly, the couple can claim $5,400 in personal exemptions, twice what they can claim on two single returns. At a 28 percent tax rate, the larger exemption will reduce the couple's tax liability by $756 (28 percent of $2,700). Second, the standard deduction of $7,100 on a joint return is $2,850 more than the $4,250 standard deduction the husband can claim on an individual return. (The wife, filing individually with no income, cannot take the deduction.) At the couple's marginal tax rate of 28 percent, the larger deduction will reduce the couple's tax liability by $798 (28 percent of $2,850). Finally, because tax brackets for joint returns are wider than those for individual returns, $17,000 that is taxed at 28 percent on individual returns will be taxed at only 15 percent on a joint return. That lower tax rate reduces the couple's tax liability by an additional $2,210 (28 percent minus 15 percent equals 13 percent of $17,000). In combination, the three factors will lower the couple's tax liability by 6.3 percent of their adjusted gross income.

	Husband	Wife	Couple
Adjusted Gross Income	$60,000	$0	$60,000
Less personal exemptions	2,700	2,700	5,400
Less standard deduction	4,250	4,250	7,100
Equals taxable income	53,050	0	47,500
Taxable at 15 percent	25,350	0	42,350
Taxable at 28 percent	27,700	0	5,150
Tax Liability	11,559	0	7,795
		Marriage Bonus	$3,764
		As a Percentage of Adjusted Gross Income	6.3

SOURCE: Congressional Budget Office.

BOX A-3.
A MARRIAGE PENALTY WITH EARNED INCOME TAX CREDIT

A couple with two children and $32,000 in total earnings split evenly between the husband and the wife will incur a marriage penalty of $4,154 in 1998. The penalty results from two factors. First, if they were not married, both the husband and the wife could file as heads of household, each claiming one child as a dependent. As heads of household, their combined standard deductions would be $12,500, $5,400 more than the $7,100 standard deduction available on a joint return. At the couple's marginal tax rate of 15 percent, the lower deduction would increase the couple's tax liability by $810 (15 percent of $5,400). Second, filing separate returns, the husband and wife each could claim an earned income tax credit for a filer with one child of $1,672. Filing jointly, the couple would be ineligible for the credit. Thus, filing jointly the couple would owe $1,315 in taxes, rather than receiving a combined payment of $2,838. The difference is a marriage penalty equal to 13 percent of the couple's adjusted gross income.

	Husband[a]	Wife[a]	Couple
Adjusted Gross Income	$16,000	$16,000	$32,000
Less personal exemptions	5,400	5,400	10,800
Less standard deduction	6,250	6,250	7,100
Equals taxable income	4,350	4,350	14,100
Taxable at 15 percent	4,350	4,350	14,100
Basic Tax Liability	653	653	2,115
Child Credit ($400 per child)	400	400	800
Earned Income Tax Credit	1,672	1,672	0
Tax Liability After Credits	-1,419	-1,419	1,315
		Marriage Penalty	$4,154
		As a Percentage of Adjusted Gross Income	13.0

SOURCE: Congressional Budget Office.

a. The baseline for calculating the marriage penalty assumes that both husband and wife file as heads of household with one child.