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QUICK STUDY

Summary: *Discriminatory taxation of the married-couple family is neither equitable nor economically efficient, and comes at an enormous social cost. Married-couple families bear a disproportionate share of the tax burden, resulting in stagnation of their incomes. Reform of the marriage tax penalty is not enough. A neutral consumption tax would correct all of the discriminatory measures against the family and would support higher real incomes for all Americans.*

THE ROAD MAP TO TAX REFORM™

How the Tax Code Discriminates Against the Traditional Family

By David A. Hartman & Allan C. Carlson

Introduction

This report offers an analysis of current taxation of married-couple families, which is neither equitable nor economically efficient. Furthermore, discriminatory taxation of families comes at an enormous social welfare cost.

We have proved the adage: *you get more of what you subsidize and less of what you tax*. Social welfare has supported poverty and delinquency—the very problems it was supposed to solve. What is needed to end the numerous marriage tax penalties is nothing less than fundamental tax reform.

History

When the federal government tried to impose the income tax on ordinary families, there was a tax revolt unparalleled in American history. In the end, the Internal Revenue Service granted amnesty for unpaid 1941 income taxes, in return for individual agreements to allow income tax withholding starting in 1942.

Discriminatory Taxation Of The Family

The first step toward discriminatory taxation of the married-couple family was in 1952, when the "head of household" schedule gave special deductions for unwed mothers. Under the "Great Society," these benefits increased with the Earned Income Tax Credit (EITC), which gave more favorable treatment to unwed mothers than to married households.

Then, in 1969, the family became the only legal partnership to be denied income splitting or its tax equivalent. In other words, the joint income of married couples could no longer be filed as two, lower-bracket incomes. As a result, two single taxpayers paid much lower tax rates than two married taxpayers.

There was bad logic behind this new tax law. It was aimed at preventing a single-income married couple from enjoying a so-called "unfair" tax break. But the reasoning behind this provision failed to recognize that there is an obvious division of labor between two married persons, even when only one has an income. The only valid comparison is the

Table 1 Measures of Median Married-Couple Family Income & Taxation, 1965–1995

Year	Median Married Family Income (B.T., 96 $)	MMF FIT Rate	MMF Total Comp. (B.T., 96 $)	MMF FIT & Payroll Rate	MMF Total Tax Burden	MMF Total '96 Comp. After All Taxes
1965	$36,187	8.22%	$39,778	14.07%	37.54%	$24,847
1973	$46,036	10.72%	$52,828	19.54%	42.97%	$30,128
1981	$43,264	14.88%	$52,107	23.24%	46.86%	$27,792
1989	$46,774	9.88%	$59,165	20.51%	44.98%	$32,552
1995	$48,452	9.73%	$59,249	20.48%	46.44%	$31,734

taxation of the combined income of *two* single individuals with two incomes. Any other comparison is a statistical figment of the imagination.

In 1976, tax credits were given for commercial child care, but not for home care of children. Then, beginning in 1986, marriage deductions and dependent deductions began to be phased out for those families with higher incomes.

The total tax burden on the median married-couple family (MMF) has been unreasonable, as shown in Table 1. The biggest change over the past fifty years has been in federal taxation. Federal income tax on MMF income rose from 8.22 percent in 1965 to 14.69 percent by 1981—a 79 percent increase. With the growth of payroll taxes up to 1995, the total federal tax burden grew to 20.46 percent of MMF compensation.

Overall, the total cost of government (state, local and federal) has gotten much more expensive for married couples than it has for non-married taxpayers. From 1965 to 1995, the government's share of MMF income rose from 37.5 percent to 46.7 percent. Meanwhile, the government's share of total compensation increased to 39.4 percent. In other words, the median married-couple family paid 7.3 percent more of its income to the federal government than the average taxpayer.

Discriminatory Allocations of Government Spending

From 1960 to 1995, defense spending as a percentage of personal income declined 7.8 percent, from 13.1 percent to 5.3 percent. However, MMF total tax burden *grew* 7.9 percent. What was the increased tax burden funding? In 1995, a 17.7 percent share of total personal incomes represented welfare spending—an increase from 7.1 percent in 1960.

It is difficult to overstate the duress of married families with children since 1960. Increase of the total tax incidence was but the tip of the iceberg. The growth of MMF compensation before and after total tax burden is shown in Table 1. MMF total compensation after all taxes stagnated in 1973 at $30,128 in1996 dollars and by 1995 had only increased 5.3 percent to $31,734.

The increased contribution of married women to total output underscores the extent of the economic burden on the married-couple family. The workforce participation of married women with children increased from 30.5 percent in 1960 to 70.2 percent by 1995.

By 1995, the government was distributing money to unwed mothers at a rate of $20,000 per child in poverty and to the aged at an average of $20,000 per person 65 years or older—regardless of their means.

Effect on Married Family Demographics

After growing throughout the post World War II era, the marriage rate per 100 women 15 years and over peaked in the early 1970s and then dropped sharply. The United States' marriage rate has declined slowly ever since. The peak marriage rate corresponds to the 1973 peaking and stagnation of MMF compensation.

Though other social factors played a role, higher divorce rates, fewer marriages and lower fertility rates all correspond to the anti-family taxation of the federal government.

Government policies have had an overall negative effect on individual choices for marriage and married parenting. Generous welfare programs have led to disturbing changes: Out-of-wedlock births soared from 5.37 percent of total births in 1960 to 30.1 percent in 1992.

The Economics of Marriage and the Public Welfare

The breakdown of the married-couple family, the loss of community and charitable involvement because of the dual-earner claims on time, the diminished nurture of children in married families, and the institutionalized care for the aged are the bitter fruits that follow additional tax burdens on traditional married families.

These cultural and economic consequences call for more family-friendly government policies and a reversal of the descent into an all-encompassing welfare state. It is necessary to stop the increasing diversion of resources from socially functional and productive families to socially dysfunctional and unproductive individuals. It is particularly necessary to re-establish a reasonable tax burden to marriage and married parenthood so that we might encourage higher fertility, more nurture of children, and more educated workers to offset the graying of America.

The Anti-Family Federal Tax Code

The biases against families in the federal tax code run deep. The federal tax code discriminates against families both directly and indirectly.

- **The marriage tax penalty** This penalty results from the fact that the married-couple family is the only legal partnership not allowed by the IRS to split incomes. Consequently, two singles of the same total income as a married-couple family face lower total income taxes. The singles are privileged to both better rate schedules for separate incomes and higher standard combined deductions.
- **The married parenthood penalty** To eliminate the "married parenthood penalty" requires one of two alternatives. Either the "head of household" tax status must be eliminated, or it must be made applicable to married families. The latter could be easily accomplished if income splitting is restored, ending the primary source of the marriage tax penalty, and one of the two income splitters is taxed as the "head of household."
- **Childcare credits** To provide tax equity, mothers or family members who provide home care for children should be allowed the maximum childcare credit.
- **The Inheritance Tax (The Death Tax)** The federal government's confiscation of family capital by estate taxes results not only in massive tax avoidance planning, but also the sale or dissolution of productive family farms and businesses. Losses of investment capital, job continuity, and family ownership are of incalculable value.

Indirect Anti-Family Taxation

- **Capital Formation** Inadequate capital formation has shipped jobs abroad. Foreign investment in the United States has not been a substitute because it is money made from the sale of imports that displace American jobs. Government that taxes too much and spends too much is the root cause, and married families carry the bulk of the burden and sustain the impact of losing higher-paying jobs.
- **Border Adjustability of Taxation** Reform of the tax code is needed to enable border adjustability of a sufficient portion of the federal tax burden to level the playing field for American manufacturing jobs and investments.
- **Human Capital** The rate of immigration of unskilled and uneducated workers has outstripped the rate of social and productive assimilation. This is not a satisfactory alternative to child rearing within families. Alongside immigration, we are seeing an unconscionable "brain drain," the loss of United States intellectual capital to lower-income countries for their own development.
- **Tax Incidence** The ultimate incidence of taxation on financial capital can be shown to fall disproportionately on workers' incomes and human capital (concentrated in upper-income professions). This means that the excessive taxation of income and capital only serves the interests of government. Progressive taxation may hit upper-income taxpayers, but it hurts lower incomes more.
- **Visibility of Taxation** At present, the myth that workers and families escape the bulk of taxes through a system of progressive taxation is believed because more than 40 percent of the taxes they pay are hidden. This makes government appear to offer low- or no-cost services, rather than high-cost, inefficient services of dubious value.

Family Friendly Tax Reform

Step-by-Step Reform

One could trust in a long-range process of reforming the tax code item-by-item following focused attention to the particular problems and much debate over the remedies. However, the government and public officials believe that the incomes of the citizens are theirs to redistribute equitably, so they fight tenaciously to ensure their increasing access to citizens' pocketbooks.

Although *abolishing* the death tax has majority approval of taxpayers, the citizenry was recently offered a paltry 5 percent cut per year, with abolition of the tax remaining a distant promise. The marriage and married parenthood penalties were given only token changes, and the reforms only applied to dual-income married families with a family income below $50,000 income.

At that rate, tax reform will be a process like trying to contain an octopus by cutting tentacles that grow faster than one can prune them.

Fundamental Tax Reform

The federal tax code accounts for 70 percent of the United States' tax burden on families. Also, it creates the need for most of the remaining 30 percent (through mandated state and local entitlements). The first priority of tax reform must focus on federal taxation.

Real federal tax reform requires replacing the plethora of federal taxes with one or two simple taxes. These new taxes should meet the criteria specified in the following proposal for a constitutional amendment to replace the Sixteenth Amendment:

> "Any tax levied by government shall have only one rate, which shall be equally levied upon all citizens, and any deductions, credits, or exemptions granted to any citizen shall be equally granted to all citizens."

In practice, this would mean an end to selective favoritisms in the tax code. It could, at the same time, allow generous family allowances for a rebate of taxes on necessities. These rebates would be given to *all* families and would be based upon family size alone.

It is truly remarkable to observe how effectively fundamental federal tax reform would remedy the anti-family bias of the tax code to provide "family friendly" taxation. It is important to note that none of the effects would discriminate against unmarried families, so that the result would be "value neutral."

Estimated Value of the Tax Reform Dividend

Gary Robbins, of Fiscal Associates, has developed a 10-year projection that charts the benefits to married-couple families of fundamental tax reform. He projects married-couple family income under current tax policies and contrasts it to married-couple family income under the following reforms: 1) A 20 percent flat-rate consumption tax; 2) A tax credit for every family based at 20 percent of the poverty level income and relative to the size of the family.

To summarize the findings, *tax reform would generate an income 9.4 percent higher than projected for current income tax policies*. It must be emphasized that the bounty of this greater real prosperity is not just financial. Perhaps more important than the financial benefits is the prospect for reduced working hours per family, with the balance of time available for improving the quality of life. The tax reform dividend can be invested in richer family life, more education and better community service. Such goals make the objectives of social and fiscal conservatives one and the same.

In conclusion, fundamental tax reform would lead to the elimination of all of the anti-family biases of the present tax code and the enactment of a far more efficient, equitable, and pro-growth tax system, one that supports higher real after-tax incomes for all Americans, married-couple families or otherwise.

Table 2 Projection of the Married-Couple Family Income Tax Reform Dividend

Profile of Average Married Tax Return	Current Law				Under Reform		
(Selected Years)	1997	2001	2006	2011	2001	2006	2011
Adjusted gross income less deficit	$67,776	$81,790	$100,118	$121,436	$81,790	$102,535	$132,857
Salaries and wages	$57,671	$68,733	$83,199	$100,026	$68,733	$85,040	$108,607
Income from investments	$10,429	$13,448	$17,396	$21,989	$13,448	$17,984	$24,884
Taxable interest	$1,485	$1,914	$2,477	$3,130	$1,914	$2,560	$3,542
Dividends	$1,056	$1,362	$1,762	$2,227	$1,362	$1,822	$2,520
Sales of capital assets	$3,682	$4,747	$6,141	$7,762	$4,747	$6,349	$8,784
Business or profession	$4,206	$5,424	$7,017	$8,869	$5,424	$7,254	$10,037
Other income less loss	$175	$212	$259	$314	$212	$265	$344
Total statutory adjustments	$499	$602	$737	$894	$602	$755	$978
Average after-tax income	$60,486	$71,754	$86,547	$103,565	$71,754	$88,824	$114,785
Change in after-tax income	-	-	-	-	-	$2,277	$11,221
Percent change in after-tax income	-	-	-	-	-	2.6%	9.8%

Assumes:
CBO 2001 Baseline Forecast
Reform yields 5% real growth in 5 years
Reform yields 15% real growth in 10 years
Exemption credit is $3,000 in 2002 and indexed for inflation

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