Issue Brief

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Reducing the Marriage Penalty: A Good Way to Cut Taxes?

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With federal surpluses expected to total more than $1 trillion over the next five to ten years, attention on Capitol Hill is turning to tax cuts. Topping the list in both the House and Senate are bills to reduce the so-called "marriage penalty" in the federal income tax.

The purpose of this issue brief is to focus on how changing the tax treatment of married couples would affect the economy. As background, the first section explains how the tax code and marital status interact. The next section estimates the economic and revenue consequences of four proposals while the last section discusses whether reducing marriage penalties makes for good tax policy.

Marital Status and the Tax Code

Many parts of the federal income tax treat single individuals and married couples differently. Right at the start, the form 1040 asks whether the taxpayer is filing a single; joint; married, filing separately; or head of household return. Filing status determines the value of the standard deduction, the tax schedule the taxpayer is supposed to use and, ultimately, how much tax is owed. [See Table 1 for the standard deduction and bracket amounts by type of return.] Other parts of the tax code link credits, deductions and other tax parameters to marital status. All told, at least 66 sections of the tax code contribute to what is called the "marriage penalty." [See Table 2 for a list of provisions.]

Table 1
Federal Income Tax Brackets and Standard Deduction By Type of Return, 1998

Federal Income Tax Brackets and Standard Deduction By Type of Return, 1998

Tax Rate	Bracket Amounts		
	Single	Joint	Head of Household
15.0%	$0 to $25,350	$0 to $42,350	$0 to $33,950
28.0%	$25,350 to $61,400	$42,350 to $102,300	$33,950 to $87,700
31.0%	$61,400 to $128,100	$102,300 to $155,950	$87,000 to $142,000
36.0%	$128,100 to $278,450	$155,950 to $278,450	$142,000 to $278,450
39.6%	$278,450 +	$278,450 +	$278,450 +
Standard Deduction	**$4,250**	**$7,100**	**$6,250**

Table 2
Tax Code Provisions Affected by Marital Status

Source: American Institute of Certified Public Accountants. More information on these provisions can be found by visiting the AICPA website (www.aicpa.org\news\txmp).

Tax Code Provisions Affected by Marital Status	
1. Sec 1:	Tax Imposed on Individuals (tax rates)
2. Sec 1(g):	Certain Unearned Income of Minor Children Taxed as if Parent's Income (kiddie tax)
3. Sec 21:	Expenses for Household and Dependent Care Services Necessary for Gainful Employment (child-care credit)
4. Sec 22:	Credit for the Elderly and the Permanently and Totally Disabled (elderly credit)
5. Sec 23 and 137:	Adoption Expenses Credit and Adoption Assistance Exclusion
6. Sec 24:	Child Tax Credit
7. Sec 25A:	Hope Credit & Lifetime Learning Credit
8. Sec 32:	Earned Income Credit
9. Sec 38:	General Business Credit
10. Sec 42:	Low-Income Housing Credit
11. Sec 55:	Alternative Minimum Tax Imposed (alternative minimum tax)
12. Sec 62(b)(1):	Certain Trade and Business Expenses of Qualified Performing Artist (performing artist expense)
13. Sec 63:	Taxable Income Defined (standard deduction)
14. Sec 63(c)(6):	Certain Individuals Not Eligible for Standard Deduction (election to itemize)
15. Sec 68:	Overall Limitation on Itemized Deductions (itemized deduction limit)
16. Sec 86:	Social Security and Tier I Railroad Retirement Benefits (social security benefits)
17. Sec 125:	Cafeteria Plans
18. Sec 129:	Dependent Care Assistance Programs (employer child-care benefits)
19. Sec 135:	Income from U.S. Savings Bonds Used to Pay Higher Education Tuition and Fees (savings bonds for education)
20. Sec 147(a):	Substantial User Requirement of Certain Private Activity Bonds (private activity user)
21. Sec 147(c)(2):	Limitation of Use of Certain Private Activity Bonds for Land Acquisition (private activity first-time farmer)
22. Sec 151:	Allowance of Deduction for Personal Exemptions (personal exemptions)
23. Sec 151(d)(3):	Phaseout of Allowance of Deductions for Personal Exemptions (personal exemption phaseout)
24. Sec 162(l)(1):	Special Rules for Health Insurance Cost of Self-Employed Individuals (self-employed health insurance)
25. Sec 163(h)(3):	Qualified Residence Interest (mortgage interest deduction)
26. Sec 165:	Losses (casualty and gambling losses)
27. Sec 165(l):	Losses in Insolvent Financial Institutions (uninsured financial deposit loss)
28. Sec 172:	Net Operating Loss
29. Sec 179:	Election to Expense Certain Business Assets (section 179 assets)
30. Sec 194:	Amortization of Reforestation Expenses (reforestation deduction)
31. Sec 213:	Medical, Dental, Etc., Expenses (medical expenses)
32. Sec 219:	Retirement Savings (IRA with no employer plan and special IRA)
33. Sec 219(g):	Retirement Savings (individual retirement account with employer plan)

Table 2
Tax Code Provisions Affected by Marital Status

Tax Code Provisions Affected by Marital Status	
34. Sec 220(b):	Medical Savings Accounts (limitation on deduction)
35. Sec 220(c)(2)	(limitation on high deductible health plan)
36. Sec 221:	Interest on Education Loans
37. Sec 263A(e)(2):	Exception to Capitalization Requirements for Farming Businesses (farm deduction)
38. Sec 267:	Losses, Expense and Interest with Respect to Transactions between Related Parties (related party losses)
39. Sec 318:	Constructive Ownership of Stock (corporate ownership in distributions); also sections 302, 304
40. Sec 341:	Collapsible Corporations
41. Sec 408A:	Roth IRAs
42. Sec 408A(c)(2)(B)	(rollover from IRA)
43. Sec 424(d):	Attribution of Stock Ownership (employee stock options); also sections 422, 423
44. Sec 469:	Passive Activity Losses and Credits Limited (passive activity loss)
45. Sec 530:	Education IRA Funding Limitations
46. Sec 544:	Stock Ownership in Personal Holding Companies (personal holding companies); also sections 542,543
47. Sec 613(A)(c):	Exemption of Percentage Depletion Limitation for Independent Producers and Royalty Owners of Oil and Gas Wells (percentage depletion)
48. Sec 672:	Related or Subordinate Party to Grantor of Trust (trust income); also sections 674, 675, 677
49. Sec 704(e):	Partner’s Distributive Share of Family Partnership (family partnership)
50. Sec 911:	Citizens or Residents of the U.S. Living Abroad (foreign housing allowance)
51. Sec 1044:	Rollover of Publicly Traded Securities Gain into Specialized Small Business Investment Companies (small business rollover)
52. Sec 1092:	Straddles
53. Sec 1202:	50 Percent Exclusion for Gain from Certain Small Business Stock (small business stock exclusion)
54. Sec 1211:	Limitations on Capital Losses (capital loss)
55. Sec 1233:	Gains and Losses from Short Sales (short sales)
56. Sec 1235:	Sales or Exchange of Patents (patents)
57. Sec 1239:	Gain from Sale of Depreciable Property between Certain Related Taxpayers (related party gains)
58. Sec 1244:	Losses in Small Business Stock
59. Sec 1256(e):	Mark to Market Not to Apply to Hedging Transactions (hedging transactions)
60. Sec 1272:	Current Inclusion in Income of Original Issue Discount (original income discount)
61. Sec 1361:	S Corporation Defined
62. Sec 1563:	Controlled Group Corporation
63. Sec 6017:	Self-Employment Tax Returns (self-employment tax)
64. Sec 6096:	Designation by Individuals (presidential campaign)
65. Sec 6654:	Failure by Individual to Pay Estimated Income Tax (estimated income tax)
66. Sec 7872:	Treatment of Loans with Below-Market Interest Rates (below-market loans)

Exactly What Is the Marriage Penalty?

According to the Joint Committee on Taxation (JCT), the *marriage penalty* occurs "when the sum of the tax liabilities of two unmarried individuals filing their own tax returns (either single or head of household returns) is less than their tax liability under a joint return (if the two individuals were to marry)."[1] For example, suppose a husband and wife each earned $15,000. Filing a joint return, the federal income tax on their combined $30,000 income would be $2,625. However, if each filed a single return, each would pay $1,208 in tax on income of $15,000 for a total tax of $2,415. Being married costs this couple an extra $210 in taxes. [See Table 3 for examples of marriage penalties and bonuses.]

Table 3
Examples of Marriage Penalties and Bonuses

Based on 1998 tax parameters. Couple is assumed to have no other dependents and used the standard deduction. Some totals are rounded.

Examples of Marriage Penalties and Bonuses

	Joint	If Filing Single Return			(Penalty) /Bonus
		Spouse 1	Spouse 2	Total	
Income = $30,000					
Two Earners, 50-50 Split	2,625	1,208	1,208	2,415	(210)
Two Earners, 70-30 Split	2,625	2,108	308	2,415	(210)
One Earner	2,625	3,458	0	3,458	833
Income = $50,000					
Two Earners, 50-50 Split	5,625	2,708	2,708	5,415	(210)
Two Earners, 70-30 Split	5,625	4,559	1,208	5,766	141
One Earner	5,625	8,759	0	8,759	3,134
Income = $75,000					
Two Earners, 50-50 Split	11,995	5,259	5,259	10,517	(1,478)
Two Earners, 70-30 Split	11,995	9,459	2,333	11,791	(204)
One Earner	11,995	15,958	0	15,958	3,964

The JCT also points out that *marriage bonuses* can occur when the sum of the tax liability of two single individuals is more than what they would owe under a joint return. For example, suppose all of the couple's $30,000 income was earned by one spouse. As a single filer, the earner would pay $3,458 in tax, $833 more than what was owed by filing jointly.

As the previous two examples suggest, the existence of marriage penalties or bonuses depends on the relative incomes of the spouses.[2] In general, marriage penalties are more likely to arise for couples where the income of one spouse is at least 30 percent, but not more than 70 percent, of the other.[3] Conversely, marriage bonuses are more likely to arise if one spouse earns more than 70 percent of the couple's income.

Tax Features Giving Rise to Marriage Penalties or Bonuses

The main reason for marriage penalties or bonuses is the progressive nature of the federal income tax. The current system attempts to achieve progressivity in two ways: (1) by exempting some amount of income from tax through personal exemptions and the standard deduction and (2) by setting higher marginal rates on higher levels of income.

Rate and Standard Deduction Structure

There would be no marriage penalty if the standard deduction and bracket amounts for joint returns were double those for single returns. But, the standard deduction for joint returns is currently 1.67 times that of single returns ($7,100 for joints versus $4,250 for singles in 1998). The bracket amounts for rates of 15%, 28% and 31% on the joint tax schedule also are 1.67 times that of their single counterparts. The gap narrows even

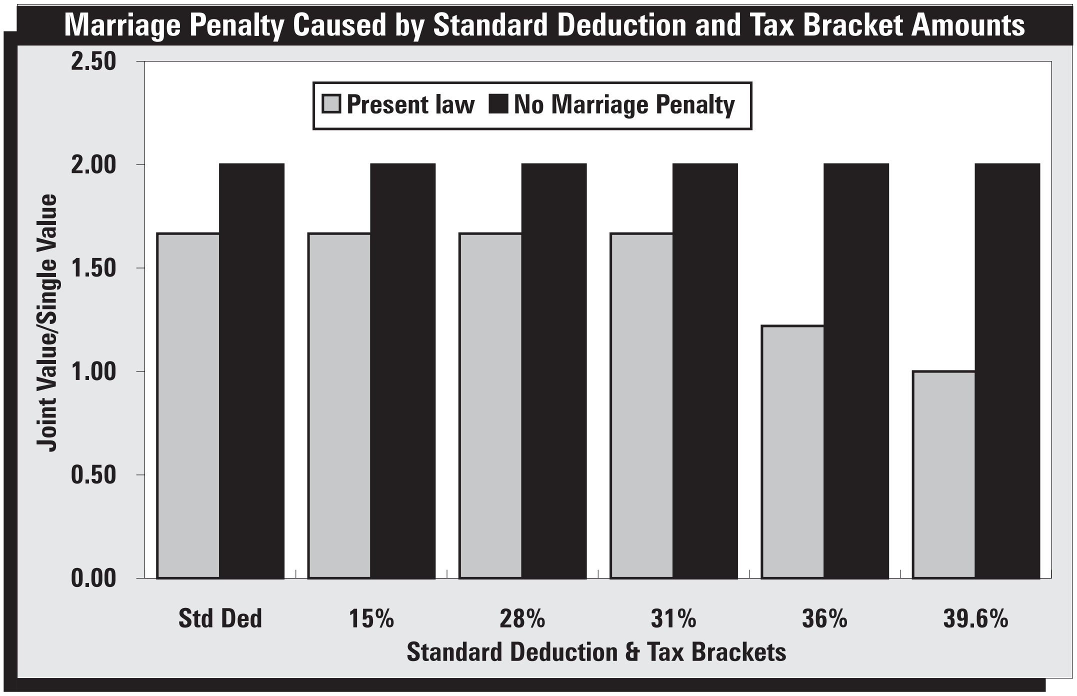


Figure 1
Marriage Penalty Caused by Standard Deduction and Tax Bracket Amounts

more at higher rates. Brackets amounts on the 36% rate for joint returns are 1.2 times that of singles while the brackets at 39.6% are the same. [See Table 1 and Figure 1 for a comparison between joint and single returns.]

Other Tax Provisions

Other parts of the tax code set limits or phase out deductions or credits based on marital status, exacerbating the marriage penalty. For example, Social Security benefits begin to be taxable for single filers whose income is more than $25,000. The income test for married beneficiaries, however, is $32,000, not $50,000. Similarly, the exemption under the alternative minimum tax (AMT) is $33,750 for singles and $45,000 for joint returns and begins to phase out at income levels of $112,500 for singles and $150,000 for joint returns. In general, disparate treatment in other parts of the tax code means that a couple filing a joint return pays more in tax than if filing as two singles. [See Table 2 for a list of tax provisions affected by marital status.]

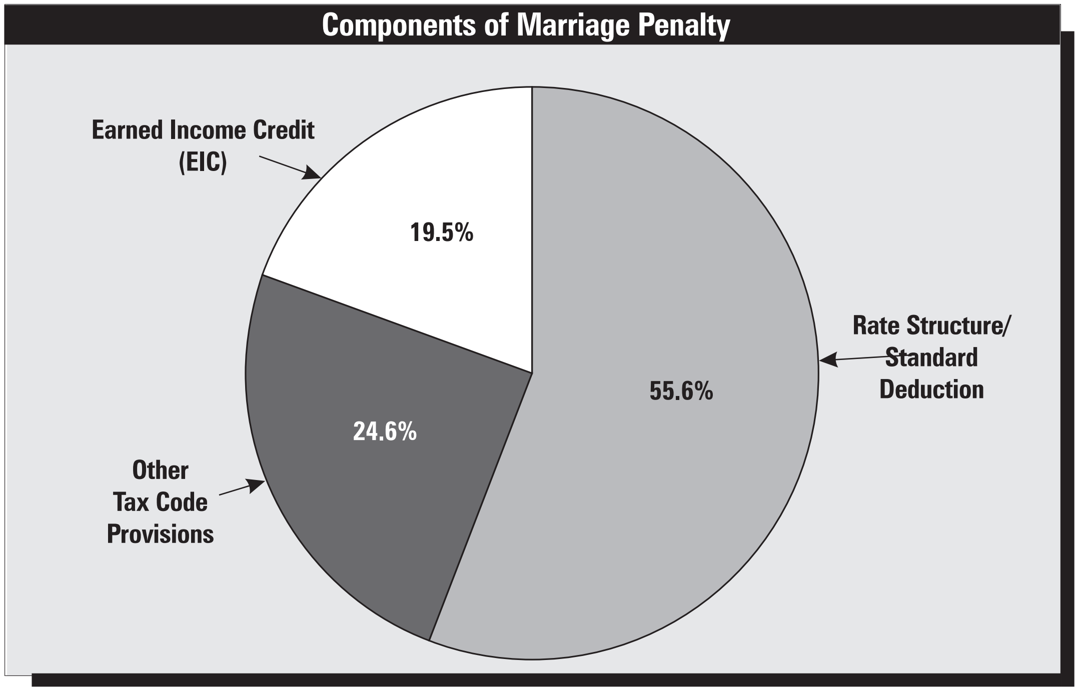
"The Earned Income Credit (EIC) also penalizes marriage because it specifies a maximum credit based on number of children, not filing status."

Earned Income Credit

The Earned Income Credit (EIC) available to lower income workers also penalizes marriage because it specifies a maximum credit based on number of children but not filing status. Married couples face a further disadvantage because eligibility and amount of the credit depend on income in such a way that a couple with two children would receive less than if they were single and each claimed one child.[4]

Of these three sources of marriage penalty, over half (55.6%) occurs because the standard deduction and bracket amounts for joint filers are not double those for singles. Other tax provisions account for another 24.6 percent, and the EIC makes up the remaining 19.5 percent. [See Figure 2 for composition of the marriage penalty.]

Figure 2
Components of Marriage Penalty



Marital Status Has Always Posed (Tax) Problems

Problems with defining the appropriate tax filing unit are nothing new. Policymakers have had to struggle with marriage penalties and bonuses almost since enactment of the federal income tax in 1913. Although the original code did not distinguish on the basis of marital status, Supreme Court decisions resulting from state community property laws finally forced Congress to set up a separate tax schedule for joint returns in 1948. Under it married couples were to pay twice the tax of a single taxpayer with half the income. In other words, there was no marriage penalty because the standard deduction and bracket amounts for joint returns were twice those for single returns.

"A revolt against the [married/single] formula Congress put in place in 1969 is underway in part because of the increase in two-earner couples."

However, this structure eventually spawned a revolt because single taxpayers found themselves paying up to 40 percent more income tax than a married couple with the same income. Congress responded in 1969 by setting the standard deduction and bracket amounts for single returns at about 60 percent those for joint returns, in effect, reintroducing a marriage penalty. This relationship has stayed pretty much the same down to the present time [See Table 4 for a brief history of marital status and the federal income tax.]

Now the pendulum has swung back to focus on marriage penalties. A revolt against the formula Congress put in place in 1969 is underway in part because of the increase in two-earner couples. Between 1969 and 1995, married couples of working age with only one earner dropped from majority (52%) to minority (28%) status. In contrast, the proportion of two-earner couples where each spouse earned at least a third of the income doubled (17% to 34%).[5] In other words, couples for whom income tax treatment was neutral to favorable have declined and been replaced by couples most likely to be penalized. [See Figure 3 for couples by spousal earnings.]

Year	Legislation and Court Decisions	Description
Brief History of Marital Status and the Federal Income Tax		
1913	**Inception of Federal Income Tax**	All individuals filed separate returns using the same schedule.
1930	**Supreme Court decisions Poe v. Seaborn, 282 U.S. and Lucas v. Earl, 281 U.S. 111**	The requirement of community property states that couples split income equally provided a basis for each spouse to pay federal income taxes on ½ of joint income. Supreme Court validated income splitting in community property states only.
1939 to 1947	**Oklahoma and Oregon enact community property rules. Other states follow.**	Less than 4 million Americans paid any income tax in 1939. But, due to war financing, 43 million were paying tax by 1945.
1948	**The Revenue Act of 1948**	Established a separate tax schedule for joint returns designed so that married couples would pay twice the tax of a single taxpayer with ½ the couple's taxable income. As a result, by 1969, single taxpayers could pay up to 40% more in income taxes than a married couple with the same income.
1969	**Tax Reform Act of 1969**	Set standard deduction and bracket amounts for singles at about 60% of those for joint returns. While eliminating the so-called "singles penalty," the change created a marriage penalty for some couples.
1981	**The Economic Recovery and Tax Act of 1981**	Created an above-the-line deduction for two-earner married couples that was the lessor of : (1) 10% of the wages and salaries of the spouse with the lower income or (2) $3,000. This helped alleviate some of the disincentive on work caused by higher marginal tax rates on the second earner.
1986	**Tax Reform Act of 1986**	Repealed the two-earner deduction while dropping the top marginal rate from 50% to 28%.
1990 to present	**Omnibus Budget Reconciliation Acts of 1990 and 1993**	Added marginal tax rates of 31%, 36% and 39.6%. Bracket amounts were set at 82% of the single amount for the 36% rate and at 100% for the 39.6% rate, increasing the marriage penalty for higher income couples. Expansion of Earned Income Credit increased marriage penalty for low income couples.

Table 4
Brief History of Marital Status and the Federal Income Tax

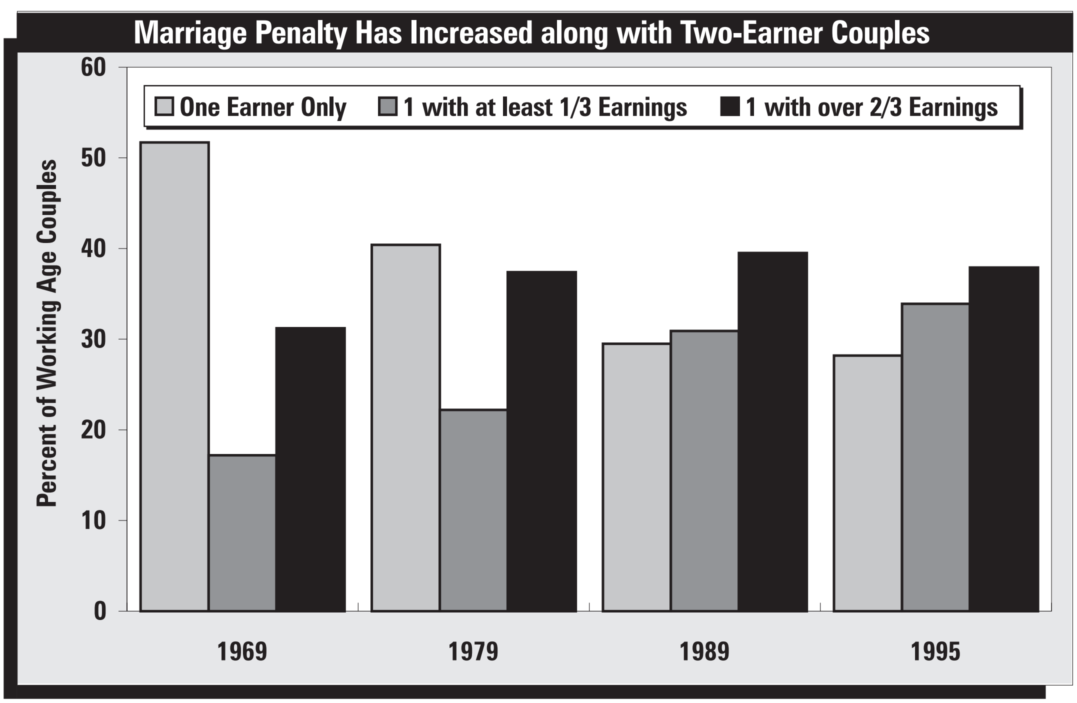


Figure 3
Marriage Penalty Has Increased along with Two-Earner Couples

Source: Congressional Budget Office tabulations of Census data

Proposed Solutions

A uniform (flat) tax rate on income is the most obvious way to end marriage penalties and bonuses. Under one rate, there is no advantage or disadvantage from splitting or combining income as in the examples shown above.

But, instead of broad-based tax reform, proposals receiving serious consideration in this Congress aim strictly at the marriage penalty. These proposals would reduce the penalty for some, but not, all couples and leave marriage bonuses largely intact.[6] None of the proposals address penalties from the Earned Income Credit.

Leading candidates, which tackle the marriage penalty problem in different ways, are as follows:

Optional Filing Status

The Marriage Tax Elimination Act (HR 2456), introduced by Congressmen Jerry Weller (R-IL) and David McIntosh (R-IN), would give couples the option to file a joint return or split their income and be taxed as two single individuals on the same return. Labor income (such as wages and pensions) would belong to the spouse who received it. Income from capital (such as dividends, capital gains and interest) would be divided based on asset ownership. For example, dividends from stock owned jointly would be split equally.

"A uniform (flat) tax rate on income is the most obvious way to end marriage penalties and bonuses. Under one rate, there is no advantage or disadvantage from splitting or combining income."

If not itemizing, each spouse would claim the standard deduction for singles. Other deductions would go to the spouse having the income to which the deduction relates. Each spouse would claim one personal exemption and the same share of any dependent exemptions as the spouse's share of income. Credits would be based on the couple's combined tax.

Optional filing status as outlined in HR 2456 would essentially eliminate the marriage penalty. Couples who opt to file separately on the same return would use the standard deduction and rate schedule for singles. Marriage penalties resulting from other parts of the tax code also would largely be negated. Marriage bonuses would remain because couples could still opt to continue filing joint returns.

The Joint Committee on Taxation (JCT) estimates the cost of HR 2456 at $101 billion over five years.

Income Splitting—Single Rate Structure Applies

The Marriage Protection and Fairness Act (HR 3104), introduced by Congressmen Bob Riley (R-AL) and Matt Salmon (R-AZ), would allow couples to split *taxable* income in half and determine tax liability using the rate schedule for singles. Couples who do not itemize would use a standard deduction twice that for singles.

Another bill, the Marriage Tax Penalty Elimination Act of 1998 (HR 3734), would achieve the same results by making the standard deduction and bracket amounts used by joint filers double those of single filers.[7] [See Figure 1.]

Both bills would eliminate the marriage penalty stemming from the standard deduction and rate schedule. However, because income-splitting operates on taxable income, marriage penalties resulting from other part of the tax code would remain. Couples currently receiving marriage bonuses also would get a tax cut because they too could evenly divide taxable income regardless of which spouse earned the income.

JCT estimates the cost of HR 3104 at $153 billion over five years.

Second-Earner Deduction

The Marriage Penalty Relief Act (HR 2593), introduced by Congressmen Wally Herger (R-CA) and Congresswoman Barbara Kennelly (D-CT) takes a third approach. Under their bill, couples with two earners could deduct from adjusted gross income 10 percent of the smaller of: (1) the earnings of the spouse with the lesser earned income and (2) $30,000. The deduction would be *above-the-line*, as with Individual Retirement Accounts, and have a maximum value of $3,000.

A limited deduction to the second earner would take care of part, but by no means all, of the marriage penalty resulting from the standard deduction and bracket amounts. It would not affect penalties arising from other parts of the tax code but would expand marriage bonuses received by couples with a second earner. [For example, the couple with $50,000 in income and a 70-30 earnings split in Table 3.]

"Optional filing status as outlined in HR 2456 would essentially eliminate the marriage penalty."

JCT puts the cost of HR 2593 at $45 billion over five years.

Optional Tax Calculation

Another alternative would be to address only the marriage penalty resulting from the rate schedule and standard deduction without creating more marriage bonuses, as income-splitting and the second-earner deduction would do. Under this option, which is not currently a bill, a couple would prepare their tax return in the same way they do under current law up to the point of calculating taxes owed. The couple would then: (1) calculate tax using the standard deduction and rate schedule for joint returns or (2) split their income, deductions and exemptions in proportion to earned income and each use the single standard deduction and rate brackets to figure the tax owed.

This proposal would completely eliminate the marriage penalty arising from the rate schedule and standard deduction while not adding to marriage bonuses. It would, however, preserve most of the other tax penalties.

Revenue and Economic Effects of Reducing the Marriage Penalty

Now we turn to the revenue and economic effects of the four proposals just discussed. The first step is to compute revenue costs using methods similar to those of government forecasters, that is, without taking macroeconomic effects into account.[8] Under current law, we estimate the individual federal income tax will raise almost $1.6 trillion from taxpayers filing jointly between 1999 and 2003. Of that, various tax penalties on marriage would amount to $129.1 billion, with $72.1 billion coming from the rate and standard deduction structure.[9] [See Table 5 for revenue estimates under current law and the four proposals.]

The income-splitting proposal would have the biggest *static* revenue loss, $159.5 billion over five years.[10] Even though the cost well exceeds the total for all three types of marriage penalties, this approach would retain most penalties due to other tax provisions and the earned income credit. About a third of the tax cut ($53.8 billion) would represent a windfall to couples not currently penalized by the tax code.

Next most expensive at $101 billion over five years would be optional filing status. Unlike income-splitting, this proposal would essentially eliminate the marriage penalty except for the earned income credit. Allowing the couple a choice of how to calculate tax would cost less, $72.1 billion, because it would only eliminate the marriage penalty arising from the rate

Table 5

Effect of Marriage Penalty Proposals on Federal Income Tax Revenues for Joint Returns

Estimated using the Fiscal Associates Tax Model.

1 The Marriage Protection and Fairness Act (HR 3104). Doubles the single standard deduction and brackets amounts.

2 The Marriage Tax Elimination Act (HR 2456)

3 Split income, deductions & family exemptions in proportion to earned income and use single standard deduction and rate schedule.

4 The Marriage Penalty Relief Act (HR 2593)

Effect of Marriage Penalty Proposals on Federal Income Tax Revenues for Joint Returns

(Amounts in $billions; Calendar Years))

Proposal	Revenues		Marriage Penalty Remaining Due to: Rate Structure & Standard Deduction		Other Tax Provisions		Earned Income Credit		Total Penalties	
	2000	1999-03	2000	1999-03	2000	1999-03	2000	1999-03	2000	1999-03
Current Law	299.6	1,588.0	13.6	72.1	6.0	31.8	4.8	25.2	24.4	129.1
Income-splitting[1]	(29.7)	(159.5)	0.0	0.0	5.4	28.6	4.8	25.2	10.2	53.8
Optional Filing Status[2]	(19.1)	(101.0)	0.0	0.0	0.0	0.0	4.8	25.2	4.8	25.2
Optional Tax Calculation[3]	(13.6)	(72.1)	0.0	0.0	5.5	28.9	4.8	25.2	10.2	54.1
Second-Earner Deduction[4]	(9.5)	(50.5)	8.3	43.9	5.7	30.4	4.8	25.2	18.8	99.4

and standard deduction structure. Neither proposal would give windfalls to couples not currently penalized.

Least expensive at $50.5 billion would be the second-earner deduction. However, over 60 percent of the marriage penalty would remain for two reasons. First, a maximum deduction of $3,000 greatly limits relief to upper-income couples where penalties are the greatest. Second, some of the tax cut would go to couples not currently penalized by the tax code.

Table 6

Effect of Marriage Penalty Proposals on Marginal Federal Income Tax Rates for Joint Returns

Estimated using the Fiscal Associates Tax Model.

1 The Marriage Protection and Fairness Act (HR 3104). Doubles the single standard deduction and brackets amounts.

2 The Marriage Tax Elimination Act (HR 2456)

3 Split income, deductions & family exemptions in proportion to earned income and use single standard deduction and rate schedule.

4 The Marriage Penalty Relief Act (HR 2593)

5 Average marginal federal income tax rate for joint returns using income as weights.

Effect of Marriage Penalty Proposals on Marginal Federal Income Tax Rates for Joint Returns

Proposal	Marginal Tax Rate[5]	Relative to Current Law: Change	Relative to Current Law: %Change
Current Law	24.5%	NA	NA
Income-splitting[1]	23.1%	-1.4%	-5.7%
Optional Filing Status[2]	23.5%	-1.0%	-4.1%
Optional Tax Calculation[3]	23.5%	-0.6%	-2.5%
Second-Earner Deduction[4]	23.9%	-0.6%	-2.3%

Once static revenue effects are estimated, the next step is to determine what happens to marginal tax rates. The laws of economics tell us that workers supply labor based on take-home pay and investors allocate portfolios based on returns after taxes. To the extent that the marriage penalty raises tax rates, it accordingly reduces labor supply, capital formation and growth.

None of the proposals would have much effect on marginal tax rates. Income-splitting would produce the largest change, dropping the marginal federal income tax for joint returns from an average 24.5 percent under current law to 23.1 percent. Marginal rates under the second-earner deduction would decline by 0.6 percentage points to 23.9 percent. [See Table 6 for the change in marginal tax rates for joint returns.]

"None of the proposals would have much effect on marginal tax rates."

These already-small changes become even smaller because joint returns account for only half the marginal tax rate imposed by the federal individual income tax. Therefore, a one percent change in the marginal tax rate for joint returns translates into 0.5 percent for the economy as a whole.

Last, we use our neoclassical, general equilibrium model of the U.S. economy to measure the effects on output, capital and labor from the changes in economy-wide marginal tax rates that would occur under each of the four proposals.[11] As Table 7 shows, economic effects are likewise small. A dollar of tax cut from reducing the marriage penalty would increase GDP between 60 and 81 cents. In contrast, a dollar of tax cut from cutting rates across the board would yield a dollar of increased GDP. Because of limited economic gains, only between a fifth and a quarter of the static revenue loss would be offset.

Good Tax Policy?

A tax system should interfere with market operations as little as possible. In practice that means taxing all productive elements of the economy at the same rate. By this measure, there is plenty of room for improving the U.S. tax system. At present, federal, state and local taxes take almost 39 percent of national income on average. What is more, the next dollar of labor income faces a tax rate of over 42 percent. The marginal tax rate on capital income is almost 50 percent higher than labor's.[12]

Table 7
Growth Potential from Marriage Penalty Proposals (Expressed as Change per $ of Tax Cut)

Growth Potential from Marriage Penalty Proposals (Expressed as Change per $ of Tax Cut)

Proposal	Increase in GDP	Revenue Offset
Income-splitting[1]	$0.63	$0.21
Optional Filing Status[2]	$0.71	$0.24
Optional Tax Calculation[3]	$0.60	$0.20
Second-Earner Deduction[4]	$0.81	$0.27

Estimated using the Fiscal Associates Model.

[1] The Marriage Protection and Fairness Act (HR 3104). Doubles the single standard deduction and brackets amounts.

[2] The Marriage Tax Elimination Act (HR 2456)

[3] Split income, deductions & family exemptions in proportion to earned income and use single standard deduction and rate schedule.

[4] The Marriage Penalty Relief Act (HR 2593)

"If the aim is to reduce marriage penalties, the optional filing status or tax calculation proposals would do so without creating more windfalls."

The previous section has shown that reducing the marriage penalty would do little to lower marginal tax rates or equalize tax rates on labor and capital. Tax relief in the form of either rate cuts or lower taxes on saving and investment would be a better use of tax dollars in that regard.

But, some would argue that tax policy should have other goals such as equity. The problem is that what seems "fair" to one person may well seem "unjust" to another. For example, the tax treatment for married couples now being advanced was scrapped 30 years ago for being unfair to singles. What this about-face reveals is that fairness is a political, not economic, issue inevitably settled through the ballot box.

Unlike the issue of taxation and economic efficiency, there is no scientific basis for deciding the right answer. However, if the aim is to reduce marriage penalties, the optional filing status or tax calculation proposals would do so without creating more windfalls.

Conclusion

Reducing the marriage penalty is akin to child and tuition credits contained in last year's tax bill. Targeted tax cuts like these do little to improve economic efficiency or advance the cause of sound tax policy. With the federal tax bite larger than ever before, perhaps policymakers could put the trillion-plus dollar budget surplus to better use by cutting taxes on everybody, not just selected groups.

Endnotes

1 Joint Committee on Taxation, *Present Law and Background Relating to Proposals to Reduce the Marriage Tax Penalty* (JCX-1-98), January 27, 1998, p. 2.

2 For more discussion of marriage penalties and bonuses, see The Congressional Budget Office, *For Better or Worse: Marriage and the Federal Income Tax*, June 1997.

3 Joint Committee on Taxation, p. 2.

4 The maximum credit is $341 for no children; $2,271 for one child and $3,756 for two or more children. For more discussion see Shahira E. Knight, *Reducing Marriage Taxes: Issues and Proposals*, Joint Economic Committee, May 1998.

5 Congressional Budget Office, Ch. 4.

6 See Knight, Table 3.

7 HR 3734 was introduced by the main sponsors of the three other marriage penalty bills examined in the issue brief, Congressmen Jerry Weller, David McIntosh, Bob Riley and Wally Herger.

8 We used the Fiscal Associates Tax Model which contains historical information on personal income, including its labor component, from the *Statistics of Income* for 72 income classes over the period 1954-93. This data contains information from the Internal Revenue Service on the distribution of income items reported on tax returns for the major components of income by Adjusted Gross Income, marital status, and type of deduction. The Tax Model separates individuals into groups that are homogeneous with respect to the aftertax prices they face and computes effective average and marginal tax rates using the population and income weights of the groups. We extrapolate these data to the year 2010 to be consistent with the latest economic baseline from the Congressional Budget Office. Besides average and marginal tax rates, the tax model also provides measures of aggregate tax liability.

9 Our estimate is consistent with the Congressional Budget Office's measure of the marriage penalty which it labels as "Basic Measures less Head of Household and EITC." See CBO, Table 4.

10 Because tax return data does not identify families with more than one earner, we used Census information compiled by the Congressional Budget Office to divide joint returns into three groups: one earner; two earners with an earnings split of 83-17 and two earners split 58-42. Penalties were calculated by allocating income between the two earners and computing taxes as if the two were single individuals. Exemptions and itemized deductions were similarly split. Results for the two earners were added and compared to the current law tax attributable to joint returns. Our revenue estimates, which are done on a calendar year basis, are in line with fiscal year estimates of the Joint Committee on Taxation.

11 The Fiscal Associates Inc. Model incorporates taxes through their effects on the returns to labor and capital. Economic effects are expressed as a change from a baseline forecast that describes how the economy would perform without any change in policy. The Model baseline, which currently has the U.S. economy growing at a long-run, real rate of 2.5 percent a year, is similar to those used by the Congressional Budget Office and the Office of Management and Budget. For more on the Model see Gary and Aldona Robbins, *Accounting for Growth: Incorporating Dynamic Analysis into Revenue Estimation*, Institute for Policy Innovation, Policy Report No. 138, July 1996.

12 For a discussion of economic efficiency and average and marginal tax rates, see Aldona and Gary Robbins, *Looking Back to Move Forward: What Tax Policy Costs Americans and the Economy,* Institute for Policy Innovation, Tax Action Analysis, Policy Report No. 127, September 1994.