

CRS Report for Congress

Received through the CRS Web

Marriage Tax Penalties: Legislative Proposals in the 106th Congress

Updated July 14, 2000

Gregg A. Eesenwein
Specialist in Public Finance
Government and Finance Division

ABSTRACT

Eliminating marriage tax penalties and creating a marriage neutral income tax is an elusive equity goal. Many legislative proposals have been advanced to solve this problem. However, marriage neutrality conflicts with two other concepts of equity: progressivity and equal taxation of couples with equal incomes. Regardless of how these three concepts of equity are juggled, an income tax cannot simultaneously achieve all three equity goals. This report will be updated as legislative action warrants. For detailed background information on the causes of marriage tax penalties, conflicting equity goals and historical tax treatment of marital status see CRS Report 97-109, *The Federal Income Tax and Marriage Neutrality*, by Gregg A. Esenwein.

Marriage Tax Penalties: Legislative Proposals in the Second Session of the 106th Congress

Summary

Eliminating marriage tax penalties and creating a marriage neutral income tax is an elusive equity goal. Marriage neutrality conflicts with two other concepts of equity: progressivity and equal taxation of couples with equal incomes. Regardless of how these three concepts of equity are juggled, an income tax can achieve any two of these goals but cannot, under current definitions, simultaneously achieve all three.

In August 1999, Congress passed the Taxpayer Refund and Relief Act of 1999 (H.R. 2488) which attempted to solve the marriage penalty conundrum by increasing the standard deduction for joint returns to twice that of single returns and by increasing the width of the lowest tax bracket for joint returns to twice that of single returns. This tax bill, however, was vetoed by the President in September.

Marriage penalty tax relief is receiving renewed attention in the second session of the 106th Congress. On February 10, 2000, the House approved The Marriage Tax Penalty Relief Act of 2000 (H.R. 6). It would have increased the standard deduction for joint returns to twice that of single returns, increased the width of the lowest tax bracket for joint returns to twice that of single returns, raised the phaseout limit on the earned income tax credit by \$2,000 for married couples and repealed the current law alternative minimum tax restrictions on the refundable personal tax credits.

On March 30, 2000, the Senate Finance Committee approved the Marriage Tax Relief Act of 2000 (S. 2346). It increased the standard deduction for joint returns to twice the amount of the standard deduction for single returns, increased the width of both the 15% and 28% tax brackets for joint returns to twice the size of the corresponding tax rate brackets for single returns, and increased the phase-out income level for the EITC for joint returns by \$2,500. Additionally, it made permanent the current law provision that allows personal nonrefundable tax credits to offset both regular and alternative minimum tax liabilities. The full Senate was not able to get the 60 votes needed to invoke cloture on the bill so the bill was never sent to the Senate floor.

On June 28, 2000, the Senate Finance Committee passed the 1st of two tax related reconciliation bills scheduled for consideration this year. This 1st reconciliation bill contained marriage tax relief provisions identical to those in S. 2346. However, due to Budget Act procedural rules, these provisions would sunset on December 31, 2004. This reconciliation bill is scheduled for full Senate consideration sometime before the August recess.

On July 12, the House passed its version of the 1st tax reconciliation bill (H.R. 4810) which contained tax provisions addressing the marriage tax penalty that were identical to those passed earlier in H.R. 6.

Contents

Legislative Approaches	2
Optional Separate Filing	3
Income Splitting	4
Second-Earner Deduction	6
Analysis	6

Marriage Tax Penalties: Legislative Proposals in the Second Session of the 106th Congress

From an economics perspective, it is an accepted goal that the individual income tax should be marriage neutral. Marriage neutrality means that the tax system should not influence the choice of individuals with regard to marital status. From this perspective, a couple's combined federal income tax liability should be the same if they are married or if they are single.

Marriage neutrality conflicts with two other often cited goals of the tax system, that the tax system should be progressive and that couples with the same total incomes should pay the same amount of income tax. It is not possible to simultaneously achieve all three goals: marriage neutrality, progressivity, and equal taxation of couples with the same incomes.

The most important structural features affecting the marriage neutrality of the income tax are the earned income tax credit (EITC), the standard deduction, and the tax rate schedules. Under the current income tax system, single individuals, heads of households, and married couples are subject to different standard deductions and tax rate schedules. The EITC amounts and phaseout ranges also vary according to filing status.¹

For example, consider the 1999 tax year standard deductions for joint and single returns. The standard deduction is \$7,200 for a joint return and \$4,300 for a single return. Hence, two singles get a combined standard deduction of \$8,600 compared to \$7,400 for a joint return. To be marriage neutral the joint standard deduction would have to be twice the amount of the single standard deduction. Structural asymmetries also appear in the marginal tax rate brackets where the joint return marginal tax rate brackets are less than twice the width of the marginal tax rate brackets for single returns.

Because of these differences, when the income of one spouse is added to the income of the other spouse, a married couple might find themselves paying either more federal income tax (a marriage penalty) or less federal income tax (a marriage bonus) than they would by filing as two singles. The Congressional Budget Office (CBO) estimated that for tax year 1999, approximately 43% of married couples incur

¹ This report does not address the problem of marriage neutrality or family tax issues in detail. That would require an analysis of the appropriate tax treatment of singles versus heads of households versus married couples, the role of family size, and the role of the EITC. For a more detailed analysis of family tax issues see: CRS Report 98-653, *The Marriage Penalty and Other Family Tax Issues*, by Jane Gravelle.

a marriage tax penalty, 52% incur a marriage tax bonus, and 5% are unaffected.² By CBO's measure aggregate marriage tax penalties will be around \$32 billion while aggregate bonuses will be around \$43 billion.

In general, the division of earned income, or income split, of the two individuals determines whether a couple will have a marriage tax bonus or penalty. The largest marriage tax bonuses occur when one spouse earns 100% of the income. The more evenly divided the income the more likely a married couple will experience a marriage tax penalty. The largest marriage tax penalties occur where the income is evenly divided between the two spouses, a 50/50 income split.

Legislative Approaches

Legislative approaches in the 106th Congress to the problem of marriage tax penalties in the federal income tax code have fallen into three main categories: those proposing some form of second-earner marital deductions, those proposing optional separate filing, and those proposing income splitting (including proposals to increase the standard deduction for joint returns to twice that of single returns).

The Financial Freedom Act of 1999 (H.R. 2488) passed by the House in the summer of 1999 included provisions that would have increased the standard deduction for joint returns to twice that of single returns. The Taxpayer Refund Act of 1999 passed by the Senate in the summer of 1999 would have allowed married couples to file as two single individuals on a joint return and would have adjusted the earned income tax credit (EITC) to provide additional marriage penalty tax relief for low income households.

The conference agreement that ultimately produced the Taxpayer Refund and Relief Act of 1999 (H.R. 2488) combined elements of both the House and Senate bills. This bill would have increased the standard deduction for joint returns to twice the amount of the standard deduction for single returns with the change phased in over five years starting in 2001. It would have also increased the width of the new 14% tax bracket for joint returns to twice the width of the 14% tax bracket for single returns. This change would have been phased in over a four year period beginning in 2005. In addition, this bill would have increased the beginning point of the earned income tax phase out for joint returns by \$2,000 in 2006. These provisions were estimated by the Joint Committee on Taxation (JCT) to cost \$117 billion between 2001 and 2009.

The legislative approach passed by the House on February 10, 2000, is very similar to the approach taken in the Taxpayer Refund and Relief Act of 1999. The House proposal, The Marriage Tax Penalty Relief Act of 2000 (H.R. 6), would increase the standard deduction for joint returns to twice that of single returns, increase the width of the lowest tax bracket for joint returns to twice that of single returns, and raise the phaseout limit on the earned income tax credit by \$2,000 for

² Congressional Budget Office. *Updated Estimates of Marriage Penalties and Bonuses*. September 1998. Also, *For Better or for Worse: Marriage and the Federal Income Tax*. Washington, June 1997.

married couples. The increase in the standard deduction and the increased phaseout limit for the EITC would be effective starting in 2001. The increase in the 15% tax bracket would be phased in over six years beginning in 2003. These changes are estimated by the JCT to cost \$50 billion over five years and \$182 billion over ten years.

On March 30, 2000, the Senate Finance Committee approved the Marriage Tax Relief Act of 2000 (S. 2346). This bill increases the standard deduction for joint returns to twice the amount of the standard deduction for single returns effective for tax years starting after December 31, 2000. The bill also increases the width of both the 15% and 28% tax brackets for joint returns to twice the size of the corresponding tax rate brackets for single returns with these changes starting in 2002 and phasing in over six years. The bill would also increase the phase-out income level for the EITC for joint returns by \$2,500 effective in 2001. Additionally, S. 2346 makes permanent the current law provision that allows personal nonrefundable tax credits to offset both regular and alternative minimum tax liabilities. These changes are estimated by the JCT to cost over \$247 billion over 10 years.

The full Senate, however, was not able to get the 60 votes needed to invoke cloture on the bill so the bill was never sent to the Senate floor. On June 28, 2000, the Senate Finance Committee passed the 1st of two tax related reconciliation bills scheduled for consideration this year. This 1st reconciliation bill contained marriage tax relief provisions identical to those in S. 2346. However, due to Budget Act procedural rules, these provisions would sunset on December 31, 2004. This reconciliation bill is estimated to cost \$55 billion over its five year life span and is scheduled for full Senate consideration sometime before the August recess.

On July 12, 2000, the House passed its version of the 1st tax related reconciliation bill (H.R. 4810). It contains provisions addressing the marriage penalty tax that are identical to the provisions contained in the early bill, H.R. 6.

President Clinton, in his State of the Union Address, proposed that the marriage tax penalty be reduced by increasing the standard deduction for two-earner married couples to twice that of single filers. In addition, the President proposes to increase the standard deduction for one-earner married couples by \$500 and the standard deduction for singles by \$250. These particular aspects of the President's overall tax agenda are estimated by the Treasury Department to cost about \$45 billion over ten years.

Senator John McCain has proposed expanding the 15% tax bracket to \$35,000 for singles and to \$70,000 for married couples. His proposal would also make the standard deduction for joint returns twice the size of the standard deduction for single returns.³

The following paragraphs discuss the main legislative approaches to solving the marriage tax penalty problem.

³ CRS Report RS20424, *Tax Proposals of the Presidential Candidates*, by Jane Gravelle.

Optional Separate Filing. Optional separate filing would allow married couples the option to file as two single taxpayers rather than file a joint return as a married couple. As the name implies, this option would allow married couples to file as two single individuals on the same return or to continue to file a joint return, the decision being based on which option produced the lowest income tax liability.

The Taxpayer Refund Act of 1999 passed by the Senate in the summer of 1999, would have permitted married couples to file as two singles on the same return. If the married couple decided to file as two singles the following rules would have applied. Earned income would be taxed to the spouse earning the income. Capital income would be divided based on ownership rights in the property. Under the Senate approach the couple could elect to either use a standard deduction or itemize. If they took the standard deduction, each spouse would be allowed the standard deduction for a single individual. If they itemized, deductions would be allocated to the spouse having the income to which the deduction was related.

Each spouse would be allowed one personal exemption. Exemptions for dependents would be allocated based on relative shares of total income. Tax liability for each spouse would be calculated on the basis of the tax rates applicable to single individuals. Credits would be determined based on joint return rules and applied against the combined tax liability of the couple. Under the Senate bill these provisions were scheduled to begin in tax year 2005.

In general, optional separate filing would mean that couples who currently incur marriage tax penalties could, by filing as two singles, eliminate their marriage tax penalties. Couples who currently have marriage tax bonuses could continue to file joint returns and thus would see no change in their federal income tax liabilities. Although eliminating marriage tax penalties this option would not make the federal income tax marriage neutral since it would maintain marriage tax bonuses. This approach would also fail to achieve the equity goal that married couples with similar incomes pay similar amounts of federal income tax. The differences in income tax liabilities between couples with similar incomes could be much larger than they would be under a second-earner deduction approach. Finally, optional separate filing would be relatively costly in terms of forgone federal revenue.

Income Splitting. Another major legislative approach to solving the marriage tax penalty problem is income splitting. Under this approach married couples would add up all their income and then split it into halves. Each spouse would then file as a single individual and pay tax on half the total income. Exemptions, deductions and credits would also be split evenly between the two spouses. The Marriage Tax Elimination Act (S. 15) sponsored by Senator Hutchison takes this approach.

An alternative approach, but one that has the same practical effect would be to increase the standard deduction for joint returns to twice the size of the standard deduction for single returns and to increase the width of the tax brackets for joint returns to twice that of single returns. It is the approach contained in The Marriage Tax Elimination Act of 1999 (H.R. 6) and the Marriage Tax Relief Act of 2000 (S. 2346). The Marriage Tax Penalty Elimination Act of 1999 (S. 12) introduced by Senator Hutchison would also increase the standard deduction and tax brackets for joint returns to twice those of single returns.

Assuming the current tax rate schedules, income splitting would give all married taxpayers a tax cut equal to the largest possible marriage tax penalty that could occur at any given income level. Married couples would all receive a tax cut regardless of whether or not they currently incur a marriage tax penalty. This means that married couples who currently receive a marriage tax bonus (they pay less filing a joint return than they would filing two single returns) would see their bonus increased. Other married couples would move from the penalty category into the bonus category.

This approach would create a singles' tax penalty (one's income tax liability would always go down by getting married) and therefore, in some regards, would move the income tax system further away from marriage neutrality than it is under the current system. Since, in 1996, there were 65 million tax returns filed by single individuals and heads of households versus 44 million returns filed by married couples, adopting an approach that would be perceived by many as creating a large singles' tax penalty might produce a negative reaction. Income splitting would probably entail the largest revenue costs of the three major options under consideration.

A variation of this theme would simply increase the standard deduction for joint returns so that it would be twice the size of the standard deduction for single returns but would not change the width of the tax brackets. This is the approach that was taken by the Financial Freedom Act of 1999 passed by the House on July 22, 1999. It is also the approach contained in several pieces of legislation including the Marriage Penalty Elimination Act of 1999 (S. 284) introduced by Senator McCain, the Marriage Penalty Relief Act (H.R. 108) introduced by Representative Knollenberg, and H.R. 725 introduced by Representative Kleczka. The Joint Tax Committee estimates that increasing the standard deduction for joint returns so that it is twice the size of the standard deduction for single returns will cost approximately \$44.5 billion over a ten-year period.

While increasing the standard deduction for joint returns so that it is twice the amount of the standard deduction for single returns would be a far less costly option than full income splitting, it would not make the tax system marriage neutral. Although this approach would eliminate the marriage tax penalty for some married couples who do not itemize and mitigate the penalty for other couples who do not itemize, it would increase the marriage tax bonuses for other married couples and not affect couples who do not use the standard deduction, i.e. itemize, and who currently pay a tax penalty.

The Taxpayer Relief and Refund Act of 1999 (H.R. 2488) combined a doubling of the standard deduction for joint returns to twice that of singles with a widening of the first tax bracket for joint returns so that it would be twice the width of the first tax bracket for single returns. This approach would eliminate the marriage tax penalty for many two-earner families. At the same time, it would increase marriage tax bonuses for other couples and hence, result in a singles' tax penalty over the affected income ranges. The Taxpayer Relief and Refund Act of 1999 was ultimately vetoed by President Clinton.

As of April 2000, this approach has been revived in both the House (H.R. 6) and in the Senate (S. 2346). Once again, while these two bills would eliminate or mitigate some couples' marriage tax penalties, they would also produce significant increases

in marriage tax bonuses for other couples and hence, produce an increase in singles' tax penalties.

Second-Earner Deduction. A second-earner deduction would allow the lower-earning spouse to deduct a percentage of his/her earned income (wage and salary income) from the couple's taxable income base. The percentage of income deductible and the base to which it applies vary from proposal to proposal.

This approach was used in the federal income tax between 1981 and 1986. The Economic Recovery Tax Act of 1981 contained second-earner deduction provisions designed to reduce marriage tax penalties. Under the Act, two-earner married couples were allowed to reduce their taxable income by an amount equal to 10% of the lower earning spouse's earned income. The maximum deduction was \$2,000. This second earner marital deduction was repealed in the Tax Reform Act of 1986.

Senator Daschle has introduced the Income Security and Enhancement Act of 1999 (S. 8), which would reinstate a second-earner deduction. Under his bill, for married couples with adjusted gross incomes (AGIs) under \$50,000, the second-earner deduction would be 20% of the lower-earning spouse's earned income. The deduction would be phased out for couples with AGIs in excess of \$50,000 and would be reduced to zero for couples with AGIs in excess of \$70,000.

A second-earner deduction would eliminate marriage tax penalties for some couples, reduce penalties for other couples, and increase or produce marriage tax bonuses for yet other couples. This approach fails to achieve the equity principle that couples with the same total income should pay the same amount of federal income tax. It is, however, the least expensive legislative option.

Analysis

It appears that in the current discussions over how to tax married couples the central economic concern — achieving a marriage neutral income tax — may have become secondary to the current debate over how to allocate a tax cut among different types of married couples.

One way to achieve a marriage neutral income tax would be to adopt mandatory separate filing. This approach would require that each spouse file a separate return and pay tax on his or her own income. While this approach would make the tax system marriage neutral it would violate the equity goal that couples with equal incomes pay equal taxes. More importantly, since over half of the married couples currently experience marriage tax bonuses (they pay less tax filing a joint return than they would by filing as two singles) mandatory separate filing would mean that these couples would incur tax increases.

Creating a truly marriage neutral income tax, which would entail eliminating marriage tax bonuses along with marriage tax penalties, does not appear to be a current legislative goal. In the past, most of the legislative emphasis focused on either the elimination or mitigation of marriage tax penalties. Some of the recent legislative proposals would shift the focus from marriage neutrality to providing a tax

cut to all married couples whether or not they actually incur marriage tax penalties under current law.

All current legislative proposals to address the marriage tax problem of the federal income tax code affect other widely shared concepts of equity. Optional separate filing and second-earner deductions violate the concept of equal taxation of couples with equal incomes. Income splitting makes the tax system less marriage neutral by creating large singles tax penalties.

Economists have suggested that part of the problem may be solved by modifying the definition of what constitutes equal couples. Economics recognizes that two-earner couples and one-earner couples with the same incomes are not really equal since the one-earner couple normally benefits from the extra time available to the non-working spouse. This time benefit is not available to the two-earner couple. Hence, by redefining what constitutes equal couples, some observers believe that the federal income tax could be progressive, marriage neutral, and tax couples with equal incomes and circumstances equally.

This approach might include moving towards a schedular income tax system: individuals, including each spouse, would each calculate separate tax liabilities on their own earned income. Deductions and exemptions would be allocated between spouses in accordance with each spouse's percentage of total earned income. Capital income would be attributed to the higher earner spouse and taxed at their marginal tax rate. Tax credits would then be applied to the combined tax liabilities of both spouses. Although this approach would not achieve full marriage neutrality, it would make the federal income tax system marriage neutral with respect to labor income.