

# LOW-INCOME FAMILIES AND THE MARRIAGE TAX

Laura Wheaton

Promoting marriage was one of the primary goals of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. But for most two-earner couples, the tax system does not support this goal. A couple with two children and \$11,000 in earnings each loses \$1,491 in annual after-tax income simply by virtue of marriage. Marriage penalties are highest as a percentage of income for low-income couples, who are also penalized by the phaseout of such transfer programs as food stamps and Medicaid. Penalties from the tax system and penalties from the transfer system combine to cost low-income married couples as much as 30 percent of their income.

Current interest in reducing marriage penalties in the tax code provides Congress with an opportunity to substantially reduce the tax price of marriage for many low- and middle-income families, but only if the proposals are designed with these families in mind. Of the marriage penalty proposals recently considered, some would do little for lower-income families because they do not address the penalties arising from the phaseout of the Earned Income Tax Credit (EITC)—a refundable credit that subsidizes low-income families' earnings. Others target low- to middle-income couples but are not efficient—providing equal amounts of tax relief to couples regardless of whether they pay a marriage penalty or receive a marriage subsidy.

This brief addresses the following questions:

- Just how are dual-earner, low-income couples penalized under the current tax system?
- What are the pros and cons of the current congressional proposals to remedy the marriage penalty problem?
- What strategy would go further than these proposals in reducing marriage penalties for low-income families?

## Who Is Affected and How?

Not all married couples are subject to *marriage penalties*. Slightly over half pay *lower* taxes as a result of marriage. These couples receive *marriage subsidies* under the tax system. In general, couples in which one spouse earns all or most of the income receive marriage subsidies, while those with two similar income earners pay marriage penalties. This pattern of subsidies and penalties is the natural outcome of a tax system that is both progressive and based on family rather than individual income.

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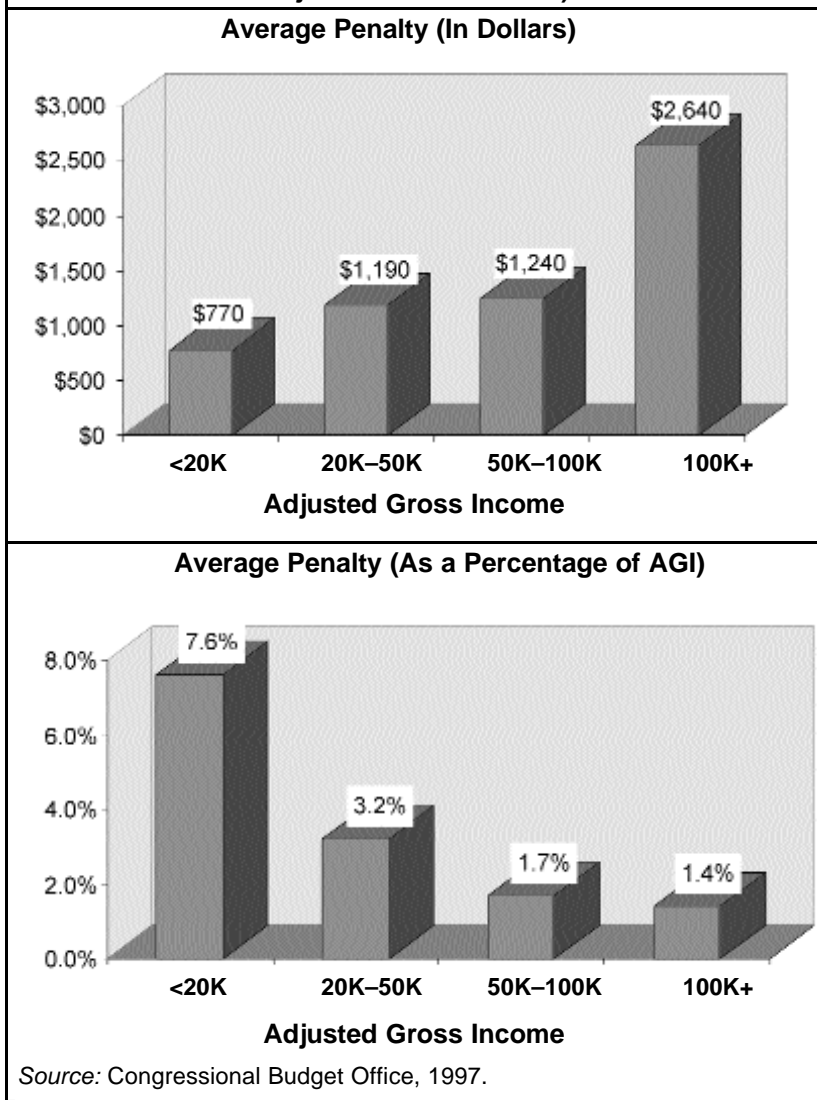
In 1996, the income tax system created \$32.9 billion in marriage subsidies and \$28.8 billion in marriage penalties. Over half of married couples received marriage subsidies, 42 percent incurred marriage penalties, and 6 percent were unaffected, according to the Congressional Budget Office (CBO). The new child credit enacted in 1997 will reduce marriage penalties, but if the number of two-earner couples continues to grow, more couples will face penalties in the future.

Higher-income couples receive most of the subsidies and pay most of the penalties. These couples pay a disproportionate share of penalties because they are more likely than lower-income couples to have a penalty, and their average penalties are higher. As shown in figure 1 (top panel), average penalties in 1996 ranged from \$770 for couples with less than \$20,000 of income to \$2,640 for couples with more than \$100,000.



**FIGURE 1**

**Average Marriage Penalty by Income Class, Projected 1996 (In Dollars and As Percentage of Adjusted Gross Income)**



Higher-income couples are more likely to pay penalties because they are more likely to have two earners; single-earner couples incur no marriage penalties.

However, even though low-income couples pay the smallest amounts in tax penalties and are the least likely to be penalized by the tax system, those who are penalized pay the highest share of their income on penalties (figure 1, bottom panel). Marriage penalties average 7.6 percent of the income of

couples with less than \$20,000, but only 1.4 percent of the income of couples with more than \$100,000. Under certain conditions, marriage penalties can be much higher for two-earner, low-income couples—more than one-fourth of earnings if each spouse has two children and earns \$11,610.

Marriage penalties and subsidies vary depending on how the couple's income is divided between the husband and wife. Table 1 shows penalties and subsidies for

low- and middle-income couples with two children, under various assumptions about the wife's income as a percentage of the couple's income. The table assumes that if the couple were not married, the children would live with their mother, who would file a head-of-household return.

Several factors contribute to subsidies and penalties at the income levels shown here. If the wife does not earn enough to take full advantage of exemptions—the head-of-household deduction, the child credit, and the EITC—marriage reduces taxes as the wife's unused tax benefits are applied to the husband's earnings. But couples with two earners may be penalized because the standard deduction and tax brackets for joint filers are less than the sum of those for a single and head-of-household filer and because combining two incomes often reduces the EITC.

The interaction of these various factors explains the pattern of subsidies and penalties in table 1. As seen by the substantial marriage bonuses in the first column, single men marrying nonworking women with children gain from their wives' unused tax benefits, garnering marriage subsidies ranging from about 9 percent to over 40 percent, depending on income. But a two-earner couple in which each spouse earns \$15,000 is hardest hit, paying a penalty equal to 8.8 percent of their income—mostly from the phaseout of the EITC.

Alternative assumptions about family characteristics and tax filing status in the absence of marriage would yield different results. Penalties would tend to be greater (and subsidies smaller) if (as CBO assumes) each parent would claim one child as a dependent and file as head of household. Marriage penalties and subsidies would tend to be smaller if the alternative to marriage is cohabitation and the



man (if not actually the father) raises the children as his own. Some tax analysts would omit head-of-household filing status and the EITC from the marriage penalty calculation, arguing that these are subsidies, not taxes. Doing so would significantly lower subsidy and penalty estimates at these levels.

what would be earned by a minimum-wage worker working full-time for a full year. Taxes are calculated separately for the husband and wife as if they were not married. The children are assumed to live with the wife, who would file as head of household. Subtracting the sum of the husband's and wife's separate taxes from the couple's joint tax yields the marriage penalty of

\$1,491 or 6.8 percent of the couple's combined incomes.

The couple's marriage penalty arises from the phaseout of the EITC. At \$11,000 of income, the wife receives the maximum credit for two children—\$3,656. But at \$22,000 of income, the couple is well into the phaseout range of the EITC and is eligible for a credit of only \$1,535, which is \$2,121 less

## Low-Income Families and the EITC

Most of the marriage penalties and bonuses for low-income families originate with the EITC. The EITC is a refundable credit that first reduces a family's income tax (if any) to zero. Any remaining EITC is then paid to the family. The amount of the EITC depends on the family's earned income, adjusted gross income (AGI), and number of children. In 1997, a family with two children and income up to \$9,140—the phase-in range of the credit—received 40 cents in EITC payments for every dollar earned. Those with income between \$9,140 and \$11,930—the flat range of the credit—received the maximum credit of \$3,656. For those earning between \$11,930 and \$29,290—the phaseout range of the credit—the EITC was reduced by 21 cents for each additional dollar of income, until reaching zero at \$29,290.

When a low-wage working man marries a nonworking woman with children, the couple receives a substantial EITC bonus, as much as \$3,656 in 1997 if the man earned between \$9,140 and \$11,930 and the couple had no other income. But if the woman works and has income in the flat or phaseout range of the credit, getting married reduces or eliminates the EITC.

Table 2 shows the marriage penalty for a married couple with two children and annual earnings of \$11,000 each—slightly more than

**TABLE 1**

**Marriage Penalties and Subsidies as a Percentage of Couple's Income, by Percentage of Income Earned by Wife**  
(Assumes two children, fully phased-in 1997 tax law, \$500 child credit)

Couple's Income	Percentage of Couple's Income Earned by Wife				
	0	25%	50%	75%	100%
\$10,000	41.4%	25.9%	13.2%	4.6%	0.0%
\$15,000	28.3%	14.5%	0.4%	6.2%	0.0%
\$20,000	19.7%	5.9%	6.1%	6.9%	0.0%
\$30,000	8.7%	5.1%	8.8%	7.0%	1.8%
\$40,000	9.3%	6.4%	5.9%	1.2%	1.3%
\$50,000	10.0%	4.0%	2.8%	1.0%	1.8%

*Note:* Shaded cells represent marriage penalties, unshaded cells represent marriage subsidies. Table assumes that if the couple were not married the children would live with their mother, who would claim them as dependents and file a head-of-household return, and that the father would file a single return. Taxpayers are assumed to take the standard deduction.

*Source:* Urban Institute, 1998.

**TABLE 2**

**Marriage Penalty for a Low-Income, Dual-Earner Couple with Two Children**  
(Assumes 1997 tax law with \$500 child credit)

	Tax If Not Married		Tax If Married
	Husband	Wife	
<b>Earnings</b>	\$11,000	\$11,000	\$22,000
Less exemptions	2,650	7,950	10,600
Less standard deduction	4,150	6,050	6,900
Equals taxable income	4,200	0	4,500
<b>Tax (at 15 percent)</b>	630	0	675
Less child credit	0	0	675
Less EITC	0	3,656	1,535
Equals tax liability	630	-3,656	-1,535
		Marriage Penalty	\$1,491
		As Percent of Income	6.8%

*Source:* Urban Institute, 1998.



than what the woman alone would receive if she were not married.

The marriage penalty from the EITC is somewhat offset by a marriage bonus from the new child credit enacted under the Taxpayer Relief Act of 1997. When it is fully phased in beginning in 1999, taxpayers can subtract from their taxes \$500 for each dependent child. However, the child credit benefits only those taxpayers who have some taxable income. In the example above, the wife has no taxable income after exemptions and the standard deduction, so does not benefit from the child credit. The husband has taxable income but does not live with the children, so cannot benefit from the child credit. Married, the couple has taxable income of \$4,500 and taxes (before credits) of \$675. The couple has two dependent children so is potentially eligible for a child credit of \$1,000. However, since the credit is nonrefundable, the couple receives only the \$675 necessary to reduce taxes to zero. Without the child credit, the

couple's marriage penalty would have been \$2,166—nearly 50 percent higher.

### Proposed Marriage Penalty Relief

The Taxpayer Relief Act of 1998 (H.R. 4579) was recently introduced by Rep. Bill Archer, R-TX, and passed by the House Ways and Means Committee. The Archer bill includes a marriage penalty relief provision that would set the standard deduction for joint filers at twice that for single filers. Several other approaches to reducing marriage penalties have been proposed during the past year. As table 3 shows, the choice of approach greatly influences who would benefit from marriage penalty relief and by how much.

Most of the recent proposals would provide equal benefits to couples receiving marriage subsidies and those paying marriage penalties. Under the Archer bill, a couple with

\$40,000 would receive a \$210 tax cut, regardless of whether the couple currently has a \$3,717 marriage subsidy or a \$2,351 marriage penalty. Higher-income subsidized couples would particularly benefit from a bill introduced by Sen. Lauch Faircloth, R-NC (S. 1285), that would allow couples to file a combined return in which each spouse is taxed separately on half of the couple's combined income. Bills aimed more specifically at couples paying marriage penalties include those introduced by Sen. Tom Daschle, D-SD (S. 2147); Rep. Wally Herger, R-CA (H.R. 2593); and Reps. Jerry Weller, R-IL, and David McIntosh, R-IN (H.R. 2456). Weller-McIntosh resembles Faircloth, except that under it each spouse would be taxed on his or her own income, and so single-earner couples would not benefit. The Daschle and Herger bills would make tax relief contingent upon a second earner.

The proposals would have differing impacts on low-, middle-, and higher-income taxpayers. Middle-

**TABLE 3**

**Marriage Subsidies and Penalties under Current Law and Tax Relief under Various Marriage Penalty Relief Proposals<sup>a</sup>**

Couple's Income	One-Earner Couple			Two-Earner Couple <sup>b</sup>		
	\$22,000	\$40,000	\$100,000	\$22,000	\$40,000	\$100,000
<b>Marriage Subsidy or Penalty</b>						
Subsidy	\$3,815	\$3,717	\$5,378	–	–	–
Penalty	–	–	–	\$1,491	\$2,351	\$2,015
<b>Tax Relief Under</b>						
Weller-McIntosh (H.R. 2456) <sup>c</sup>	–	–	–	–	210	1,053
Faircloth (S. 1285) <sup>c</sup>	–	210	1,053	–	210	1,053
Archer (H.R. 4579)	–	210	–	–	210	–
Herger (H.R. 2593)	–	–	–	–	300	840
Daschle (S. 2147)	–	–	–	464	600	–
Gramm (S. 2436)	695	495	–	695	495	–
Neal-McDermott (H.R. 3995)	859	–	–	859	–	–

a. If proposal had been law in 1997. Table assumes two children, fully phased-in 1997 tax law, \$500 child credit, all income is from labor earnings, and \$20,000 in itemized deductions for the couple earning \$100,000. If not married, one spouse would claim the children as dependents and file as head of household. The other spouse (the earner in the one-earner couple) would file a single return.

b. Assumes each spouse earns half of the couple's income (and has half of itemized deductions).

c. Marriage penalty is not eliminated for the \$100,000 two-earner couple because these proposals do not address penalties arising from head-of-household filing status.

Source: Urban Institute, 1998.



income taxpayers are the primary beneficiaries of the Archer bill, since most higher-income taxpayers itemize deductions. Higher-income taxpayers would benefit most from proposals that allow married couples to be taxed separately on a combined return (Faircloth and Weller-McIntosh) or that set tax brackets and the standard deduc-

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tion for joint filers to twice that for single filers (Weller, H.R. 3734, not shown). Herger's second-earner deduction would benefit both middle- and higher-income taxpayers. These proposals would not help a couple with \$22,000 and two children because they do not address the marriage penalties arising from the phaseout of the EITC.

The Daschle proposal, and those introduced by Sen. Phil Gramm, R-TX (S. 2436), and Reps. Richard E. Neal, D-MA, and Jim McDermott, D-WA (H.R. 3995), would help low- and middle-income couples. By reducing the marriage penalties arising from the phaseout of the EITC, these are the only proposals that would help the couple earning \$22,000. Daschle's second-earner deduction and Gramm's special deduction for joint filers would help low-income taxpayers because the deduction would count against earnings in calculating the phaseout of the EITC. These deductions would also help middle-income taxpayers, but higher-income taxpayers would not be allowed the deduction. The Neal-McDermott proposal would provide more generous EITC payments to married couples in the phaseout range of the EITC.

## Targeting Relief to Low-Income Couples

For a marriage penalty relief proposal to be efficiently targeted to low- and middle-income couples, it should address the penalties in the EITC phaseout and be contingent upon the presence of a second earner, since one-earner couples already receive marriage subsidies. The Daschle proposal meets these criteria, but it includes a phaseout that increases the marginal tax rate for couples with between \$50,000 and \$60,000 in adjusted gross income.

It is possible to direct substantial marriage penalty relief to low-income, two-earner couples and at the same time avoid a phaseout. Consider an option to increase the standard deduction for two-earner couples by an amount equal to the second earner's income up to a maximum of \$5,000. This approach would increase the beginning and end of the phaseout of the EITC by the same amount and would substantially reduce marriage penalties for low- and middle-income couples. For a couple with two children in which each spouse earns \$11,000, the marriage penalty would be reduced by \$1,053 (70 percent). If each spouse earned \$20,000, the reduction would be \$750 (32 percent).

Tying marriage penalty relief to the standard deduction reduces the number of high-income couples that would benefit, without requiring a phaseout. Some higher-income taxpayers would find it worthwhile to take the standard deduction under this option, but most would not since their itemized deductions would continue to exceed the standard deduction.

Basing tax relief on the presence of a second earner ensures that single-earner couples who already incur marriage subsidies do not benefit, though some relief would go to two-

earner couples with dissimilar earnings who receive marriage subsidies. A potential advantage of a second-earner deduction is that it reduces work disincentives for a second earning spouse. Research shows that second earners' hours are not sensitive to taxes but that the decision about whether to work at all is. Thus, this option would encourage labor force participation by second earners in low- and middle-income families.

### About the Author

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### Related Reading

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