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TAXING MARRIAGE: Microeconomic Behavioral Responses to the Marriage Penalty and Reforms for the 21st Century

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ABSTRACT

Politicians often stress that marriage is a key institution that promotes family values. However, many aspects of the federal tax code do not promote marriage and may in fact provide disincentives and penalize marriage. As an alternative to marriage, cohabitation is a common choice for low-income couples facing significant fiscal penalization from the joint income filing requirement, particularly when qualifying for the Earned Income Tax Credit (EITC). In part because of the additional tax liability associated with joint tax filing, many middle-income and upper-income people are forgoing marriage as well. As more women enter the labor force and female wages rise, the marriage penalty becomes increasingly important to horizontal tax equity concerns and for economic growth. Today, the United States is one of only seven Organisation for Economic Co-operation and Development (OECD) countries to employ joint taxation for married couples.¹

¹ James R. Alm and Mikhail I. Melnik, "Taxing the 'Family' in the Individual Income Tax," Andrew Young School of Policy Studies at Georgia State University, July 2004, 19, http://aysps.gsu.edu/publications/2004/alm/taxing_family.pdf.

Microeconomic Behavioral Responses to the Marriage Penalty

I. Introduction

Politicians often stress that marriage is a key institution that promotes strong family values. However, some aspects of the federal tax code do not promote marriage. Due to the structuring of joint income filing, many couples face significant tax disincentives to marriage. This paper refers to the “marriage penalty” as the disadvantageous tax treatment of a married couple’s income relative to two individuals earning an equivalent income but choosing cohabitation over marriage.² Economists Daniel R. Feenberg and Harvey S. Rosen note that for some low-income couples in 1990, “The size of the marriage tax is now quite extraordinary, amounting to over 18 percent of total income.”³ Many of these marriage penalties remain unchanged. Additionally, given the generally more elastic labor supply of married women, wives in all income ranges may face strong incentives not to work due to the marriage penalty.⁴ In 1942, feminist activist Florence Guy Seabury sent a letter to the *New York Times* regarding the proposal for joint income taxation at the time. She wrote, “To those who know the long struggle of women in this country to own property, to control their earnings, to be guardians of their children, to move out of the subject class, this measure is a symbol. It represents the defeat of a major principle of our

² Married couples must choose to file either a joint return (married filing jointly) or separately (married filing separately). However, using the “married filing separately” filing status is not the same as filing as a “single” person. Filing under the status “married filing separately” is generally considered to be the least beneficial filing status because these taxpayers are not allowed to claim all of the deductions and credits that are allowed under the other filing statuses. Further, the income level at which the 25 percent, 28 percent, 33 percent, and 35 percent marginal tax rates begin to apply are lower for those filing “married filing separately” than for those filing either as “single” or “married filing jointly,” an obvious penalty.

³ Daniel R. Feenberg and Harvey S. Rosen, “Recent Developments in the Marriage Tax” (National Bureau of Economic Research [NBER] working paper no. 4705, NBER, Cambridge, MA, April 1994), 15, <http://www.nber.org/papers/w4705.pdf>.

⁴ Sara LaLumia, “The Effects of Joint Taxation of Married Couples on Labor Supply and Non-wage Income,” *Journal of Public Economics* 92, no. 7 (July 2008): 1700.

way of life.”⁵ At the time, wide disparity existed between male and female labor force participation rates and wages. Today, with increasingly equivalent wages across genders and a majority female working population as of 2010, reducing the marriage penalty makes more sense than ever before.⁶

Not all joint filers in the tax code receive a marriage penalty, however. Some receive a “marriage bonus.” A marriage bonus is advantageous tax treatment of a married couple’s combined income relative to two individual filers earning an equivalent income. The marriage bonus most commonly emerges among single-earner households. Marriage penalties, however, most commonly occur within two-earner homes. Where marriage penalties are strongest, the tax code acts as a financial disincentive to marriage.⁷ Marriage penalties are predominantly borne between two groups of two-earner couples: (1) low-income two-earner families filing for the earned income tax credit (EITC) and (2) low- and middle-income two-earner couples for which the two salaries are roughly equal (for example, see the section “Under Current Law” in the table). These marriage penalties are strongest among low-income households utilizing the EITC,⁸ the same households that would potentially benefit most from the acclaimed sociological benefits of marriage.⁹ Where marriage bonuses are present, the tax code discourages labor force

⁵ Florence Guy Seabury, Letter to the editor, *New York Times*, May 25, 1942.

⁶ *The Economist*, “We Did It!” December 30, 2009, <http://www.economist.com/node/15174489> (accessed January 28, 2012).

⁷ Leslie A. Whittington and James Alm, “Tax Reductions, Tax Changes, and the Marriage Penalty,” *National Tax Journal* 54, no. 3 (September 2001): 455–72; and James Alm and Leslie A. Whittington, “Shacking Up or Shelling Out: Income Taxes, Marriage, and Cohabitation,” *Review of Economics of the Household* 1, no. 3 (2003): 169–86.

⁸ The EITC is a federal tax credit for low- to moderate-income individuals and married couples. The credit predominantly applies to filers with one or more children and has three different phase-out schedules for one, two, or three or more children. Many two-earner couples would experience a diminished credit if married since the delay in schedule phase-out is not double the single filer credit.

⁹ For example, see Laura Wheaton, “Low-Income Families and the Marriage Tax,” Urban Institute *Strengthening Families* brief, September 1998, http://www.urban.org/uploadedpdf/marriage_tax.pdf; Robert I. Lerman, “How Do Marriage, Cohabitation, and Single Parenthood Affect the Material Hardships of Families with Children?” U.S. Department of Health and Human Services, July 2002, <http://aspe.hhs.gov/hsp/marriage-well-being03/SippPaper.htm>; and Heather J. Bachman, Rebekah Levine Coley, and P. Lindsay Chase-Lansdale, “Is

participation among secondary earners, predominantly women. A higher marginal tax rate for a single-earner household more strongly depresses the economic return of a potential secondary earner. On their own and not married, the secondary earner could experience an entry marginal tax rate of 10 percent rather than 25 percent or higher. As a result, certain economic growth and productivity is forgone as a consequence of the married filing status requirement. An ideal tax code would be neutral with respect to marriage; in other words, the decision to enter into marriage would not be adversely affected by the tax code.

This paper proceeds in section II by examining the differential tax treatment of marriage depending on whether a joint income return has a single or two-earner status in addition to considerations of the EITC. The effect of the marriage penalty is then examined in sections III–V for (1) the incentives to transition from cohabitation to marriage and (2) the incentives to go from marriage to divorce. The marriage bonus is examined for its negative effects on female labor supply. The paper concludes in section VI by examining reform alternatives including the adoption of a proportional tax, income splitting, or, more simply, allowing married couples to file individually as if single. Each of these reforms would generate greater horizontal tax equity among couples, not penalize marriage and family promotion among low-income taxpayers, and increase national productivity by establishing lower marginal tax rates for secondary earners to enter the labor force.

It is also timely and important to recognize that under current federal law the marriage penalty is set to increase at the end of the year. Tax reforms passed in 2001 and 2003 (the so-called Bush tax cuts) included many provisions that decreased the marriage penalty. Without action from Congress and the President, these provisions will expire at the end of 2012. For

Maternal Marriage Beneficial for Low-Income Adolescents?" *Applied Developmental Science* 13, no. 4 (2009): 153–71, <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2871334/pdf/nihms195004.pdf>.

example, currently the standard deduction and bottom two income tax brackets for married taxpayers filing a joint return are twice the amount as those for single filers, preventing the marriage penalty from hitting lower-income married couples. Starting in 2013, without legislative action, the two lowest income brackets for joint filers will narrow and the standard deduction for joint filers will decrease, resulting in higher marriage penalties for many lower- and middle-income married couples. This paper recommends that the U.S. tax code reform to an individual filing system regardless of marriage status to achieve marriage neutrality, equity, and increased economic efficiency of labor.

II. The Effect of the Marriage Penalty on Existing Marriages

No marriage penalty or marriage tax appears in the tax code per se. The penalty phenomenon emerges as an economic effect of joint taxation on two-earner income. Williams College economist Sara LaLumia examines the historical effect of joint taxation: “Joint taxation equalizes the marginal tax rates of a husband and wife. Because husbands tended to earn more than wives, the introduction of joint taxation lowered husbands’ marginal tax rates and raised wives’ marginal tax rates, on average.”¹⁰ Historically, joint taxation has not caused a marriage penalty for the majority of families as traditionally men were breadwinners while women raised children and managed the home. As the proportion of women entering the labor force from 1960 to 2000 increased and female wages rose the marriage penalty became an increasingly common issue among two-earner marriages. Economists Michael Bar and Oksana Leukhina note the trending rise in female labor force participation during the 40 years: “The proportion of two-

¹⁰ Sara LaLumia, “The Effects of Joint Taxation of Married Couples on Labor Supply and Non-wage Income,” 1699.

earner couples among married couples of working age in the U.S. rose from 34% to 77%.”¹¹ As the number of two-earner households rises, the tax code plays a more prominent role in discouraging income via a secondary earner because the secondary earner’s first dollar is often taxed at a higher rate due to marriage. These marginal tax rates are then significantly distorted by factors such as the EITC, tax code treatment of the earned income difference within a two-earner household, and family size.

Low-income couples face particularly strong marriage disincentives in the joint income salary range of \$30,000–\$50,000.¹² As a percentage of income, the \$30,000–\$50,000 range experiences the highest penalty as the EITC is phased out for both earners.¹³ A substantial package of transfer benefits for having children can create strong financial incentives for divorce among current joint filers and to maintain cohabitation among single filers.¹⁴

Tax law generates significant horizontal inequalities based on each earner’s income and how many children they have. Horizontal inequality means identically sized families earning the same household income are taxed differently. Joint income filing penalizes marriage where income earners are similar.¹⁵ For example, the tax code subsidizes single-worker families earning \$60,000 while it taxes a two-earner household earning \$60,000 (see table). This generates horizontal inequity among families earning identical wages. Additionally, if the couple chooses to marry, the family may incur a marriage penalty or benefit.

¹¹ Michael Bar and Oksana Leukhina, “To Work or Not to Work: Did Tax Reforms Affect Labor Force Participation of Married Couples?” *The B.E. Journal of Macroeconomics* 9, no. 1 (2009): 1

¹² Nada Eissa and Hilary Williamson Hoynes, “Explaining the Fall and Rise in the Tax Cost of Marriage: The Effect of Tax Laws and Demographic Trends, 1984–97,” *National Tax Journal* 53, no. 3, part 2 (September 2000): 685.

¹³ Whittington and Alm, “Tax Reductions, Tax Changes, and the Marriage Penalty,” 469.

¹⁴ Feenberg and Rosen, “Recent Developments in the Marriage Tax.”

¹⁵ *Ibid.*, 10.

Table: Effects of Various Proposals on Tax Liability of Couples

	50-50 Earnings: \$30,000 and \$30,000	100-0 Earnings: \$60,000 and \$0	50-50 Earnings: \$150,000 and \$150,000	100-0 Earnings: \$300,000 and \$0
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Current Law

Single Liabilities	\$5,308	\$8,769	\$56,102	\$66,021
Joint Liability	\$6,391	\$5,304	\$60,435	\$60,435
Penalty/(Bonus)	\$1,083	(\$3,465)	\$4,333	(\$5,586)
Horizontal Equity	No	No	No	No
Effect on Secondary Earner Labor Participation	Neutral	Negative	Neutral	Negative

Mandatory Single Filing

Single Liabilities	\$5,308	\$8,769	\$56,102	\$66,021
Joint Liability	\$5,308	\$8,769	\$56,102	\$66,021
Penalty/(Bonus)	\$0	\$0	\$0	\$0
Horizontal Equity	Yes	Yes	Yes	Yes
Effect on Secondary Earner Labor Participation	Neutral	Neutral	Neutral	Neutral

50-50 Income Splitting*

Single Liabilities	\$5,308	\$8,769	\$56,102	\$56,102
Joint Liability	\$5,308	\$8,769	\$57,414	\$57,414
Penalty/(Bonus)	\$0	\$0	\$1,312	\$1,312
Horizontal Equity	Yes	Yes	Yes	Yes
Effect on Secondary Earner Labor Participation	Neutral	Unknown	Neutral	Unknown

Source: Authors' calculations using IRS rates for 2012.

Note: Table assumes couples earning \$150,000 claim itemized deductions equal to 18 percent of adjusted gross income when single and when filing jointly. Table also assumes couples earning \$60,000 claim the standard deduction. *Under 50-50 income splitting, Most of the defined joint-filing brackets are twice the width of single-filer brackets. The joint filing bracket narrows progressively upon reaching the tail end of the 25 percent bracket. A pure income splitting reform would not incorporate this progressivity, thereby reducing the marriage penalty.

For those qualifying for the EITC, horizontal inequity is historically generated for families based on family size, where having one or more children actually penalizes two-earner families.

Examining the marriage penalty over 14 years, economists Nada Eissa and Hilary Hoynes find:

Penalized married taxpayers with less than \$20,000 earned income face an average marriage penalty of 8 percent of income . . . marriage tax penalties increase with family size (number of children) among EITC-eligible couples . . . a dual-earning couple with two children faces a sizeable marriage tax penalty of \$2,733 (11.4 percent of income). A similar childless couple, on the other hand, faces a tax penalty of \$210 (1 percent of income).¹⁶

The effect is that a wide diversity of tax benefits and penalties occurred as a result of marriage status. In a 1995 paper, economists Feenberg and Rosen found that 52 percent of U.S. families paid a marriage tax and 38 percent received a marriage bonus.¹⁷ Today, many of these inequities are perpetuated and will continue as long as mandatory filing based on marital status is required. The United States is one of only seven Organisation for Economic Co-operation and Development (OECD) countries to require married couples to file together.¹⁸

¹⁶ Eissa and Hoynes, “Explaining the Fall and Rise in the Tax Cost of Marriage,” 686–88.

¹⁷ Feenberg and Rosen, “Recent Developments in the Marriage Tax,” 15.

¹⁸ Alm and Melnik, “Taxing the ‘Family’ in the Individual Income Tax,” 19.

III. Marriage Incentives

Expansions of the EITC under the Tax Reform of 1986, Omnibus Reconciliation Act of 1990, and Omnibus Reconciliation Act of 1993 reduced the tax cost of marriage for low-income couples.¹⁹ Eissa and Hoynes find a steady decrease in the marriage penalty from the 1980s into the late 1990s: “Each of three tax acts passed between 1984 and 1997 reduced the marriage tax cost for the poorest families, so that marriage cost was about \$450 lower in 1997 compared to 1984.”²⁰ At the same time, these acts also expanded the benefits to single filers. Although these reforms did reduce the cost of marriage, they did not do so relative to the alternative of cohabitation. As a result, many families cannot view marriage in a financially neutral manner. Tax economists James Alm and Leslie Whittington came to a similar conclusion: “A tax plan that gives larger reductions to single individuals can actually increase the marriage penalty. In short, reducing marriage penalties is not as simple as reducing income taxes.”²¹

The 2001 and 2003 tax reforms passed under President George W. Bush are illustrative.²² These tax reforms intended to promote marriage (or reduce the tax penalty associated with marriage) by reintroducing a two-earner deduction of 10 percent on the earnings of the lower-earning spouse up to earnings of \$30,000.²³ The deduction allowed a \$3,000 maximum subtraction from income subject to federal taxation. In 2003, the White House justified the deduction claiming:

¹⁹ Eissa and Hoynes, “Explaining the Fall and Rise in the Tax Cost of Marriage,” 684.

²⁰ *Ibid.*, 704.

²¹ Whittington and Alm, “Tax Reductions, Tax Changes, and the Marriage Penalty,” 456.

²² *Economic Growth and Tax Relief Reconciliation Act of 2001*, Public Law 107-16, *U.S. Statutes at Large* 115 (2001): 38; and *Jobs and Growth Tax Relief Reconciliation Act of 2003*, Public Law 108-27, *U.S. Statutes at Large* 117 (2003): 752.

²³ Whittington and Alm, “Tax Reductions, Tax Changes, and the Marriage Penalty,” 458.

Couples frequently face a higher tax burden after they marry. High marginal tax rates act as a tollgate, limiting the access of low and moderate income earners to the middle class. The current tax code frequently taxes couples more after they get married. This marriage tax contradicts our values and any reasonable sense of fairness.²⁴

Although these reforms decreased the tax cost of marriage, they did not account for the effect on the alternative to marriage: cohabitation. While marriage costs decreased, cohabitation benefits increased at a faster rate. Whittington and Alm examined a few scenarios for a couple with \$60,000 in annual earnings (similar to the table in this paper). They find that “although the Bush tax plan lowers the liabilities of both singles and married couples, the plan lowers taxes more for singles than for married couples.”²⁵ Hence, although intending to create incentives favoring family structures, the reforms actually may encourage greater cohabitation by increasing the benefits of single filing more than those of joint income taxation. Alm and Whittington call this “a result that seems counter to the family-oriented image favored by President Bush.”²⁶

On a more positive note, a 2010 study by Hayley Fisher finds that the lowest educated individuals were four times more responsive to the financial incentives of marriage than the highest educated group.²⁷ The data suggests that public policies increasing the financial benefits of marriage without increasing a single filer’s tax liability might be more successful at promoting marriage than previously thought. Marriage neutrality among low-income earners could be successful in promoting marriage among low-income households.

²⁴ Frederick J. Feucht, L. Murphy Smith, and Robert H. Strawser, “The Negative Effect of the Marriage Penalty Tax on American Society,” *Academy of Accounting and Financial Studies Journal* 13, no. 1 (2009): 104–105, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1721205.

²⁵ Whittington and Alm, “Tax Reductions, Tax Changes, and the Marriage Penalty,” 459.

²⁶ *Ibid.*, 470.

²⁷ Hayley Fisher, “The Health Benefits of Marriage: Evidence Using Variation in Marriage Tax Penalties” (working paper, Cambridge University, Cambridge, UK, November 2010), 19, <http://131.111.165.101/postgrad/hcf26/pubs/JobMarketPaperHayleyFisher.pdf>.

IV. Divorce Incentives

One of the consequences of the implicit marriage tax is that it increases the probability of divorce for certain income ranges. Economist Stacey Dickert-Conlin finds that “most low-income couples are eligible for higher welfare benefits if they are separated rather than married.”²⁸ Lower tax liability outside of marriage is positively correlated with the decision to divorce at statistically significant levels.²⁹ Using 1990 data for her study, Dickert-Conlin finds the marriage penalty has the strongest effects at the tail ends of income distribution. In 1990:

The family at the 10th percentile in the distribution of the marriage tax penalty faces a \$3,067 marriage tax subsidy. A 50 percent reduction in the subsidy is correlated with a 10.8 percent increase in the probability of separating. . . . At the 90th percentile in the distribution of the marriage tax penalty, the family faces a marriage tax penalty of \$1,285.³⁰

Lowering the marriage penalty at the 90th percentile by 50 percent decreases the probability of separation by 4 percent. These results are largely consistent with Feenberg and Rosen, who estimated in 1994 that for a low-income couple the marriage tax combined with the EITC for two children would lead to a tax refund of \$359. If those same filers divorced and each filed under head of household status with one child, their combined tax refund would be \$4,076.³¹ In simple terms, the marriage tax is set up in such a manner that low-income couples with children have a financial incentive to divorce. As the EITC is phased out over increasing income, the married couple faces higher rates while the cohabiting couple does not. Dickert-Conlin found that “Although marital status, per se, does not affect the EITC, the joint income of a two-earner

²⁸ Stacy Dickert-Conlin, “Taxes and Transfers: Their Effects on the Decision to End a Marriage,” *Journal of Public Economics* 73, no. 2 (August 1999): 217.

²⁹ *Ibid.*, 234.

³⁰ *Ibid.*, 230.

³¹ Feenberg and Rosen, “Recent Developments in the Marriage Tax,” 7. This example is specific to a couple in which each earner receives \$10,000 per year in income with two children in the aftermath of the 1993 tax reforms.

family may exceed the maximum allowable income for EITC eligibility, but if the couple separates, at least one spouse with sufficiently low income may become eligible.”³² Any reforms addressing the marriage penalty among filers using the EITC will likely address questions of vertical equity. Vertical equity is a progressive idea contending that different incomes be taxed at different rates but provides no guidelines to define that difference.

V. Female Labor Force Participation

The Bush-era tax cuts of 2001 and 2003 helped contribute to increased female labor force participation by easing the marginal tax rates for a secondary earner choosing to participate in the labor force. Although the 10 percent deduction on the first \$30,000 of income from the second earner is not necessarily the ideal reform to address horizontal inequities within each tax bracket caused by the joint income filing status, the deduction did promote a shift toward a labor policy with less deadweight loss. Research by economists Bar and Leukhina confirmed that labor force participation among married women is more responsive to policy change the higher the husband’s earnings. Bar and Leukhina found that due to the Reagan tax reforms that reduced the marriage tax there was a 30 percent increase in female labor participation for wives whose husbands earned over \$84,000.³³

Examining the aggregate effect of tax reform that reduced the marriage penalty on female employment, Barry Bosworth and Gary Burtless found that in the 1980s married women increased annual hours of work by 7.1 percent, most significantly among the bottom quintile of income.³⁴ Controlling for demographic trends of higher female salary levels (and higher levels of

³² Dickert-Conlin, “Taxes and Transfers,” 221.

³³ Bar and Leukhina, “To Work or Not to Work?” 2.

³⁴ Eissa and Hoynes, “Explaining the Fall and Rise in the Tax Cost of Marriage,” 683.

education), economists Nada Eissa and Hilary Williamson Hoynes find that “about 55–60 percent of the change in the marriage tax is due to changing the tax laws.”³⁵

However, in some cases, particularly for low-income wives on joint filing returns, the EITC actually decreased female labor participation (by 2–4 percent in the 1970s when the EITC was introduced and by 10–12 percent when the EITC was expanded in the 1990s).³⁶ In their paper, Bar and Leukhina find that, combined with the EITC, “Secondary income is heavily taxed, because it often disqualifies the couple from the credit or reduces it substantially.”³⁷

The presented data indicates that joint income filing seems to discourage labor force participation across all income spectrums. A shift in tax policy toward marriage neutrality may increase female labor participation among low- and high-wage earners.

VI. Policy Recommendations

“In particular, although the *initial* decision to cohabit versus marry is only somewhat affected by the tax consequences, the decision to make the *transition* from cohabitation to marriage is much more significantly affected by taxes. Put differently—and colloquially—the initial decision seems determined more by ‘passion’ than ‘economics,’ but ‘cold reality’ seems more likely to enter the calculus of the transition decision.”³⁸

If politicians desire to uphold the prominence of marriage, the federal government should not penalize the institution. The alternative of cohabitation is commonly chosen when facing significant financial penalty. Even from a labor force perspective, more equal treatment of a higher-income, two-earner family could have significant implications for macroeconomic growth as labor force participation rates rise. In 1998, the Joint Economic Committee considered three different proposals that might alleviate the marriage penalty.³⁹ These include empowering married couples to select individual filing rather than requiring joint filing, income splitting, and

³⁵ Eissa and Hoynes, “Explaining the Fall and Rise in the Tax Cost of Marriage,” 685.

³⁶ Bar and Leukhina, “To Work or Not to Work?” 3.

³⁷ *Ibid.*, 14

³⁸ Alm and Whittington, “Shacking Up or Shelling Out,” 16.

³⁹ Jim Saxton, “Reducing Marriage Taxes: Issues and Proposals,” Joint Economic Committee Study, May 1998.

a second-earner deduction. The second-earner deduction became law as part of the Economic Growth and Tax Relief Reconciliation Act of 2001. Adopting the second-earner deduction has reduced the marriage penalty for married couples and encouraged female participation in the labor force, but it represents only a band-aid solution to tax reform.

Income splitting is a tax reform that maintains joint filing but adjusts for differences in tax schedules between single and joint filers.⁴⁰ The effect of the reform is that nearly all couples would see a reduced marriage penalty or an increased marriage bonus. Generally, under 50-50 income splitting, the joint income deduction is twice the single deduction and the width of the joint filing bracket is calculated by doubling single filer tax brackets. For single-earner joint filers, the marriage bonus would generally increase, while any existing marriage penalties are decreased (or bonuses increased) for two-earner joint filers. Income splitting could either encourage or discourage female labor participation rates. To the extent that income splitting would result in a lower tax rate for secondary earners in a couple, income splitting could encourage labor force participation. Although the marginal unit of additional income may be taxed at a lower rate for secondary earners, income splitting also reduces the marginal rate for the primary earner. Therefore, the reform may encourage longer hours for one spouse rather than entry into the labor market by the other. Although income splitting increases horizontal equity among single-earner or two-earner couples with the same adjusted gross income, the reform does not treat marriage in a tax-neutral manner. A number of countries have moved from taxing the family as a unit to taxing the individual.⁴¹

⁴⁰ It should be noted that a form of “income splitting” already exists in the United States. However, it applies only to owners of profitable small corporations paying themselves under categorizations of employee salaries and bonuses. It is also argued that the expanded brackets for joint filers are a form of income splitting. This paper refers to potential income splitting in the context of direct proportionality to the single tax bracket.

⁴¹ Stephen Matthews, “Trends in Top Incomes and Their Tax Policy Implications,” (OECD Taxation Working Paper No. 4, OECD, Paris, France, November 3, 2011), 37, <http://dx.doi.org/10.1787/5kg3h0v004jf-en>.

The tax reform that best promotes horizontal equity and treats marriage in a tax-neutral manner is requiring mandatory individual filing regardless of marital status. As a 1998 Joint Economic Committee publication states, “Marriage neutrality can only be achieved by reverting to a system of individual filing or through fundamental tax reform.”⁴² Politically acceptable policy recommendations tend to define the unit of taxation as the individual rather than the family.⁴³ Both the marriage benefit and penalty would be eliminated by allowing an individual schedule of taxation.⁴⁴ Eliminating the marriage penalty enables homes to benefit from sociological advantages of marriage without perverse financial motive. By removing the marriage bonus, national economic growth benefits from the skills of secondary earners no longer financially discouraged to enter the labor force. As referenced previously, the United States is one of only seven OECD countries to require joint income filing.

The Joint Economic Committee study raised concerns that optional filing would increase the complexity of the tax code. Though such a reform could increase the cost of complying with the income tax system, greater horizontal equity among taxpayers regardless of marital status would be promoted while encouraging greater labor force participation. However, using a mandatory single file system would eliminate that complexity.

Potential effects on vertical equity are worth noting and changes to the width of tax brackets may be necessary. If policymakers wish to subsidize stay-at-home parents (whether men or women) through the tax code, the value of their noneconomic labor could be recognized by an expansion of the child tax credit and dependent deduction rather than through mandatory filing status based on marital status that creates tax penalties for many married couples.

⁴² Saxton, “Reducing Marriage Taxes,” 8.

⁴³ Whittington and Alm, “Tax Reductions, Tax Changes, and the Marriage Penalty,” 472.

⁴⁴ Eissa and Hoynes, “Explaining the Fall and Rise in the Tax Cost of Marriage,” 685.

The joint income filing requirement creates horizontal inequities among couples at nearly every level of income depending on marital status, while an educated female workforce is penalized for labor force entry. The joint income filing made more sense in the 1940s when men tended to be better educated and higher paid than women. Today, women are surpassing men in many demographic and economic characteristics.

While moving fully to a mandatory single filing system might be difficult politically, at a minimum married couples should be given the freedom to choose which filing status is best for them, married filing jointly or filing individual tax returns as if they were “single” taxpayers (as opposed to the current system penalizing those using the federal filing status “married filing separately,” which has lower income thresholds at which marginal tax rates are applied).⁴⁵ Though allowing taxpayers to choose which filing status is best for them would still result in marriage bonuses for some couples, it would remove the marriage tax penalty, which creates a disincentive to marriage (over cohabitation) and female labor force participation.

Unless Congress and the President act soon, the marriage penalty is set to increase at the end of the year. Tax reforms passed in 2001 and 2003 (the so-called Bush tax cuts) included many provisions that reduced the marriage penalty, and these provisions are set to expire at the end of 2012. Now is the time for reforming the tax code to stop penalizing two-income married couples. Fostering the economic contributions of a married, educated workforce is a step toward a 21st century tax code.

⁴⁵ For a list of tax brackets and marginal tax rates by filing status, see Internal Revenue Service, “2011 Tax Rate Schedules,” in *1040 Instructions*, November 28, 2011, 98, <http://www.irs.gov/pub/irs-pdf/i1040gi.pdf>.