

Valuing Marital Commitment in our Transfer and Tax Systems

Testimony before the U.S. House of Representatives Subcommittee on Human Resources Committee on Ways and Means

C. Eugene Steuerle

*Significant portions of this testimony appeared in "Valuing Marital Commitment: The Radical Restructuring of Our Tax and Transfer Systems," *The Responsive Community* (Spring 1999). Any opinions expressed herein are solely the author's and should not be attributed to the Urban Institute, its officers, or funders.

Document date: May 22, 2001

Released online: May 22, 2001

The nonpartisan Urban Institute publishes studies, reports, and books on timely topics worthy of public consideration. The views expressed are those of the authors and should not be attributed to the Urban Institute, its trustees, its funders.

Mr. Chairman and Members of the Subcommittee:

In principle, both American voters and their elected officials want to support marriage and the family. One would expect, then, that our expenditure programs and tax code would reflect this desire. Unfortunately, this is not always the case. Instead of a consistent policy, we have a crazy quilt of expenditure and tax policies that directly affect families, some for the better, some for the worse. It is a quilt weaved with no overall pattern or shape. Today's extraordinary array of marriage penalties was not present a few decades ago. The penalties arise mainly from the high rate at which welfare and other expenditure programs reduce benefits in the presence of a spouse with earnings.

Among other programs, large marriage penalties are created by:

- Food Stamps
- Temporary Assistance to Needy Families (TANF)
- Medicaid
- Various Housing Subdues
- Supplemental Security Income
- The Earned Income Tax Credit
- The Individual Income Tax

and, for many widows, widowers, and divorced persons:

- Social Security
- Military and Foreign Service Retirement Systems.

And these are only some of the culprits. Almost the entire gamut of other income-conditioned programs—including child care benefits and energy assistance—create marriage penalties.

Marriage penalties are not inevitable. Most public expenditures are made through programs that do not create marriage penalties. Medicare, public education at the primary and secondary level, and highways are examples of public programs that generally do not create marriage penalties. These penalties can be avoided, but only through a good deal of careful thinking about design.

Required Conditions for Creating Marriage Penalties

Let me turn more precisely to the conditions under which marriage penalties arise. Marriage penalties or bonuses will arise in almost any tax or expenditure system meeting the following two conditions:

1. a subsidy or tax, explicit or implicit, assessed on the basis of household or family income or resources, and
2. different marginal or incremental subsidy, tax, or phaseout rates at different levels of income or resources.

A Critical Analysis of the Rationales Used to Justify Marriage Penalties

Taxing by Households: Penalizing Committed Sharing. Marriage penalties are acceptable to some who believe that we should grant fewer benefits or impose higher taxes on a married couple than on two single individuals with the same combined income as the couple. The argument is that there are economies of scale in households because of shared facilities and goods. One TV may be enough for two people, one person may be able to prepare a meal for two just as easily as for one, and so on. Thus, sharing is a process that adds economic benefit over and above household income.

If our sole goal were to treat all households equally on their need for help or ability to pay taxes, then technically, it is correct that the household sharing goods and services would have lesser need and greater ability than an equal-size, equal-income grouping of people not sharing a household. The problem with using this argument to justify marriage penalties is not that there are no economies of scale from sharing. There are, and, indeed, these gains reinforce other natural instincts to engage in mutual support. Economies of scale, however, apply to almost all sharing arrangements—dormitories, retirement homes, cohabitation, and so on. *Yet marital vows of allegiance are the only type of arrangement that is taxed.*

In those communities where marriage is no longer the norm—and, as the most recent census shows, these communities are

growing—this natural social incentive to achieve economies of scale in living arrangements does not disappear, but merely is converted into forms that avoid the marriage contract. For example, adult males in marriage-discouraged communities often still live with someone, only now they are more likely than before to stay with their mothers, with other relatives or friends, or in serial relationships rather than with a spouse or with their own children. The transfer and tax systems say that these males deserve significantly lower levels of taxation and higher levels of support than males with equal incomes who marry. If they are fathers, it tells them that they can support their children better by remaining unmarried.

Marriage Penalties: A Classic Liberal-Conservative Compromise. Marriage penalties are a classic example of the type of liberal-conservative compromise that has dominated policy-making for several decades. Liberals, wanting social programs to be as progressive as possible, often try to concentrate whatever benefits are available at the bottom of the income distribution. Conservatives, wanting to limit the cost to government, also want to limit the benefits. Both motives—progressivity and budget containment—are honorable. The compromise usually used to achieve these goals, however, is to phase-out benefits quickly as income (or wealth) increases in the household. This effort attempts to achieve target efficiency by maximizing help to the poor for the lowest stated expenditure cost. To tax experts, these phaseouts are equivalent to additional layers of income tax systems. As income rises, a household is implicitly taxed in the form of a reduction of benefits, with almost the same economic effect as explicit taxes.

Because each new expenditure and tax subsidy program tends to have its own unique, built-in, phase-out, households in America (and in most developed countries) literally face dozens of tax systems. For example, if I lose 50 cents of a benefit when my income goes up by \$1, the effective tax rate from that benefit program alone is 50 percent. Now think about the multiple programs in the expenditure and direct tax systems that are phased out—welfare, food stamps, housing allowances, earned income tax credits, Medicaid, child credits, educational assistance, personal exemptions, eligibility for participation in individual retirement accounts, exclusion from the minimum tax, and so on.

These high tax rates affect not only extra income earned through work. They affect any income introduced into a benefit-receiving household through marriage. Some examples are presented in [Table 1](#) and [Figure 1](#). Consider, in particular, a single head of household moving off of welfare to a minimum wage job earning \$10,710 a year—just as recent welfare reform encourages (example 4). Such an individual does succeed in moving out of (or almost out of) traditional welfare (defined as Temporary Assistance to Needy Families), but still receives a variety of other supplements, such as food stamps and earned income tax credits. The problem is that if this benefit recipient now marries a single person earning, say \$8/hr or \$16,640 a year, their combined income would fall by 22 percent, or \$7,570 because of the marriage alone!

This reality may explain in part why, in many low-income families, fathers feel little sense of accomplishment in staying around to marry and raise children. Government in effect has declared that working fathers in low-income, two-parent families are a liability. Whatever the changes in cultural standards or mores that may have led to this situation, the government has created enormous barriers to responsible fatherhood. The total income of those households dominated by income assistance, children born out of wedlock, and the absence of married couples would fall significantly if individuals in these communities would marry in patterns closer to national averages. In these communities, government has effectively pronounced that marriage is a foolish exercise—even though marriage is a principal route out of poverty.

In recent years, Congress has turned its attention to a moderate subset of all the marriage penalties: those associated with the progressive rate schedule in the individual income tax and with the requirement for joint filing in the case of married couples. It is true that during a brief period of time most marriage penalties did arise out of the progressive income tax rate schedule. But as should be clear by now, with the myriad of expenditures and tax subsidy programs that have developed over the years, the sources of marriage penalties extend far beyond those imposed by the individual income tax. To the Congress's credit, I should note that its 2001 legislation does appear to reduce some of these marriage penalties through changes in the standard deduction, tax rate structure, and the child credit.

Options for Removing or Reducing Marriage Penalties

To reduce or eliminate marriage penalties essentially involves addressing *either* of the two conditions—household filing or multiple rates—that creates the penalties. There are several approaches or options, and sometimes they can be combined. These options and some of their related difficulties are outlined below.

Flattening of the Combined Tax Rate Schedule. Complete elimination of variable rates would mean that income would face the same tax rate whether the income was combined in marriage or not. As a practical step, one could try to limit the combined marginal tax rate for low-and moderate-income individuals moving out of welfare programs to around 30 percent or 40 percent, rather than the 70 percent rate (sometimes even 100 percent or more) they now often face. Then, when they moved into the income or Social Security tax systems, they would again face a similar combined rate (in general, the 15.3 percent Social Security tax plus a 15 percent bottom rate bracket in the income tax). Marriage is effectively penalized much less, and how income is split matters less when each person faces the same tax rate inside or outside of marriage.

Note that a true flattening of tax rates at low-income levels would require reconsideration of almost every income-conditioned expenditure and tax program on the books. Today, however, these programs often do not even share administrative records and their administrators have little idea how they overlap. It would also require abandonment of the liberal-conservative compromise placing so much stress on progressivity and measured (although not always real) budget saving within every income-related program, taken one at a time. Given changes that could simultaneously be made in other features, such as the level of minimum benefit and the direct income tax rates at higher income levels, it is unclear whether overall progressivity would be reduced by this type of effort. *Nonetheless, phase-outs cannot be sought by Congress every time it deals with an individual expenditure or tax subsidy program without almost inevitably adding to marriage penalties.*

Income Splitting. A traditional option to deal with marriage penalties has been income splitting, which effectively treats married couples as if each were an individual filing a single return and reporting exactly the right share (one-half) of the couple's total income so as to minimize tax liability. Unfortunately, income splitting eliminates only those marriage penalties arising from a schedule where rates are always successively as high, or higher, at greater levels of income, a situation that is the norm in the middle- and upper-income classes from the income tax alone. But our two conditions demonstrate that marriage penalties can also occur when rates fall as income increases. Because of all the phase-outs and implicit tax schemes, the real tax system now imposes such a rate structure on a large portion of the population. Thus, when an individual moves through the phaseout ranges of the earned income tax credit, food stamps, Medicaid, the itemized deduction limitation, the IRA contribution limit, and so forth, marginal tax rates fall rather than rise.

Take the simple case of the welfare recipient who considers marriage. Assume a welfare/tax structure that provides to unmarried adults \$5,000 of benefits at zero income, no tax and no benefits at \$10,000 of income, and a tax of \$1,000 at

\$20,000 of income. Before marriage, a couple with \$0 in income for one partner and \$20,000 for the other would get benefits of \$5,000 and taxes of \$1,000 for a net benefit of \$4,000. If they marry and split their income, then each is treated as having \$10,000 of income. They then get no benefits and pay no taxes for a net benefit of \$0. The net income of the couple would fall \$4,000. Income splitting just doesn't work here.

Individual Filing. Congress could also move toward individual filing. An intriguing possibility, and one that I increasingly favor, is for wage subsidies like the earned income tax credit to accompany the worker and not the family, and for child credits or subsidies to accompany the child. Canada is currently experimenting with such an approach with respect to wage subsidies, although eligible recipients are limited to those already on welfare. I recognize that some high-income families would then get a credit or subsidy. But worrying about whether someone paying millions of dollars in tax gets a small subsidy here or there is simply not worth the trouble. On average, higher income families can be made to pay for these changes through an explicit tax rate structure. (We now have programs that allow high-income individuals to benefit from the much larger and more expensive Social Security or Medicare programs or from public school education, yet progressivity is not removed; the rich simply pay more than their share of taxes to support these systems.)

My main concern is trying to address issues related to parenthood, marriage, and work among low- and moderate-income individuals. If subsidies were applied at low wage levels on an individual basis, they would not create the current strong incentives against marriage in low-income communities. Such a step would also remove the negative impact of the welfare system, as currently structured, on the forgotten low-income male. The trick again is that once a program is aimed at the individual, marriage can have no effect on benefits or taxes paid. This type of reform could significantly change the environment of low-income communities. Consider an example: if a single mother earning \$10,000 a year received a wage rate subsidy like the earned income tax credit on an individual basis, she would not lose it if she married someone with income of his own. Similarly, if a low-earning male married into a family, he would still be eligible for any wage rate subsidy that was available for low-income workers living with dependent children. With individually based programs, his earnings would not affect his wife's, and her earnings would not affect his.

Note that many taxpayers are *already* in a world of optional individual filing. The main difference is that the benefit now is granted only to those who are able or willing to treat the act of marriage as the option.

A Comprehensive Approach

In my view, taxing a large share of marital commitments makes little sense in any society, much less one searching for ways to revive or foster community spirit among its members. After all, the primary feature of community is to share, and the most basic form of sharing is between two people or within a family. Admittedly, the research in this field does not *prove* that removal of marriage penalties would have a significant effect on behavior. It would not by itself, for instance, reverse the sexual revolution. But empirical research is not good at detecting the influences of policy on long-term social norms.

Moreover, although the marriage penalties within the income tax have been around since 1969, we have only recently moved to a society where the very large marriage penalties from income assistance and wage subsidy programs have been extended well into the middle class and beyond the stereotypical poor, nonworking, welfare recipient. It is doubtful that the long-run influences of any of these conditions have yet to be fully experienced by society.

Independently from whether marriage penalties will significantly affect behavior in a narrow sense, I believe that they have a corrosive effect on society and especially on those low-income communities most affected by marriage penalties. Marriage penalties violate almost everyone's sense of fairness because they penalize only one type of sharing: that achieved through moral and legal promises. These penalties further discourage responsible fatherhood and motherhood. Finally, where economies of scale are conjured, the reasoning mentioned at the beginning of this paper is easily turned on its head. That is, because sharing can increase the effective well-being of individuals with no increase in their nominal income, society might want to subsidize such economies of scale rather than tax them. A similar efficiency argument lies behind some of the subsidies offered for education and other income-supporting activities.

What all this implies in practical terms is that to deal with marriage penalties in a thorough manner, Congress almost inevitably has to reconsider the entire range of explicit and implicit taxes it has imposed on income. Most of the hidden taxes it has adopted over the years would need to be reconsidered, pulled into an integrated whole, and, where appropriate, replaced by direct, explicit taxes.

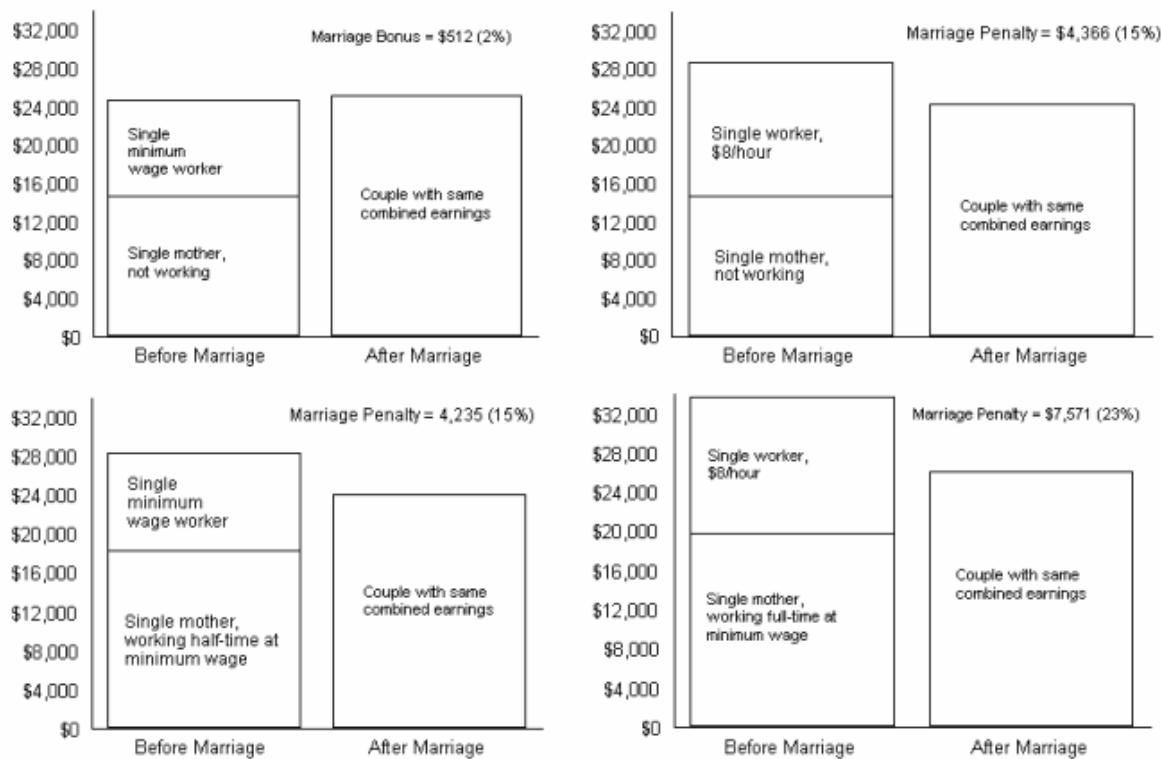
Drawing from all the options outlined above, here is a comprehensive package that would successfully change the ways our transfer and tax systems penalize marriage for low- and moderate-income individuals:

- *Reduce combined marginal tax rates on low- and moderate-income individuals so that they do not rise much above the rate that applies to middle- and higher-income individuals.*
- *Use the direct tax rate schedule as the primary means to establish overall progressivity and abandon the complicated effort to put "progressivity" into everything government does. In other words, stop adding phaseout after phaseout of benefits and subsidies.*
- *Move toward individually based rather than family-based wage subsidies for low-income workers.*
- *At least for low- and some middle-income ranges, apply income splitting rules. Congress appears on the verge of taking this step in its 2001 legislation.*

Let me be clear that the issue of how to make adjustments for children is, for the most part, a separable issue. Where adjustments are desired because of the costs of raising children, they can be achieved through child credits and dependent exemptions without giving additional bonuses to all married couples. Put another way, if the goal is to assist parents because of the presence of children, spousal benefits and bonuses are a poorly targeted device.

As I have indicated, it is not clear to me that policymakers fully comprehend what's required to achieve changes of this scale and magnitude. Incremental changes here and there may reduce marriage penalties slightly, but they may be more than offset by new marriage penalties introduced every time a new phase-out or implicit income tax is introduced. The momentum for change may need to come from acceptance of a broader principle. For example, a law might limit the combined marginal tax rate facing a low- or moderate-income worker to no more than the tax rate applying to the highest income individuals. To implement that goal, however, considerable effort would be required to coordinate administrative structures in all the government's many programs and convert the crazy quilt of family policy into a more consistently designed overall program.

Figure 1: Marriage Penalty for a Single Mother with Two Children Receiving Some Public Assistance Who Marries a Single Worker



*Income = after tax earnings + TANF + Food Stamps + Medicaid + EITC. (Does not include state CHIP benefits). Assumes 2000 rules for all programs (but 2001 tax rates). Examples use Pennsylvania which approximates the median TANF benefit state. Source: C. Eugene Steuerle and Adam Carasso, The Urban Institute, May 2001.

Table 1: Marriage Penalty for a Single Mother of Two Children Who Receives Some Public Assistance and Marries a Single Worker

Example 1: Single Mother Not Working and a Single Minimum Wage Worker

	Before Marriage	After Marriage	Marriage Penalty
Earnings	\$10,710	\$10,710	\$0
TANF Benefits	\$5,052	\$813	\$4,239
Food Stamps	\$4,644	\$3,043	\$1,601
Medicaid	\$5,457	\$7,312	\$(1,855)
EITC	\$0	\$4,008	\$(4,008)
Child Credit	\$0	\$0	\$0
Income Tax	\$(489)	\$0	\$(489)
Social Security Tax	\$(819)	\$(819)	\$0
Total Income*	\$24,555	\$25,067	\$(512)

Example 2: Single Mother Not Working and a Single \$8/hour Worker

	Before Marriage	After Marriage	Marriage Penalty
Earnings	\$16,640	\$16,640	\$0
TANF Benefits	\$5,052	\$0	\$5,052
Food Stamps	\$4,092	\$1,994	\$2,098
Medicaid	\$5,457	\$3,602	\$1,855
EITC	\$0	\$3,260	\$(3,260)
Child Credit	\$0	\$0	\$0
Income Tax	\$(1,379)	\$0	\$(1,379)
Social Security Tax	\$(1,273)	\$(1,273)	\$0
Total Income*	\$28,590	\$24,224	\$4,366

Example 3: Single Mother Working Half-Time at Minimum Wage and Single Minimum Wage Worker

	Before Marriage	After Marriage	Marriage Penalty
Earnings	\$16,060	\$16,060	\$0
TANF Benefits	\$2,377	\$0	\$2,377
Food Stamps	\$3,838	\$2,104	\$1,734
Medicaid	\$5,457	\$3,602	\$1,855
EITC	\$2,140	\$3,383	\$(1,243)
Child Credit	\$0	\$0	\$0
Income Tax	\$(489)	\$0	\$(489)
Social Security Tax	\$(1,229)	\$(1,229)	\$0
Total Income*	\$28,155	\$23,920	\$4,235

Example 4: Single Mother Working Full-Time at Minimum Wage and Single \$8/hour Worker

	Before Marriage	After Marriage	Marriage Penalty
Earnings	\$27,350	\$27,350	\$0
TANF Benefits	\$0	\$0	\$0
Food Stamps	\$2,122	\$0	\$2,122
Medicaid	\$3,602	\$0	\$3,602
EITC	\$4,008	\$1,005	\$3,003
Child Credit	\$0	\$1,000	\$(1,000)
Income Tax	\$(1,379)	\$(1,223)	\$(156)
Social Security Tax	\$(2,092)	\$(2,092)	\$0
Total Income*	\$33,611	\$26,040	\$7,571

* Income = after tax earnings + TANF + Food Stamps + Medicaid + EITC + Child Credit. (Does not include state CHIP benefits). Assumes 2000 rules for all programs (but uses 2001 tax rates). Examples use Pennsylvania which approximates the median TANF benefit state. Single HOH and married couple scenarios both have two children ages 5 and under, and no assets. Note this table does not include housing subsidies. Source: Eugene Steuerle and Adam Carasso, The Urban Institute, May 2001.

Other Publications by the Authors

- C. Eugene Steuerle

Usage and reprints: Most publications may be downloaded free of charge from the web site and may be used and copies made for research, academic, policy or other non-commercial purposes. Proper attribution is required. Posting UI research papers on other websites is permitted subject to prior approval from the Urban Institute—contact publicaffairs@urban.org.

If you are unable to access or print the PDF document please [contact us](#) or call the Publications Office at (202) 261-5687.

Disclaimer: The nonpartisan Urban Institute publishes studies, reports, and books on timely topics worthy of public consideration. The views expressed are those of the authors and should not be attributed to the Urban Institute, its trustees, or its funders. Copyright of the written materials contained within the Urban Institute website is owned or controlled by the Urban Institute.