The Hefty Penalty on Marriage Facing Many Households with Children

Adam Carasso and C. Eugene Steuerle

Summary

Over the past seventy years Congress has enacted dozens of tax and transfer programs, giving little if any attention to the marriage subsidies and penalties that they inadvertently impose. Although the programs affect both rich and poor Americans, the penalties fall most heavily on low- or moderate-income households with children. In this article, Adam Carasso and Eugene Steuerle review important penalties and subsidies, explain how they work, and help fill a big research gap by beginning to provide comprehensive data on the size of the penalties and subsidies arising from all public programs considered together.

Marriage penalties arise because of the combination of variable U.S. tax rates and joint, rather than individual, filing by married couples for benefits and taxes. If graduated taxes were accompanied by individual filing or if all income and transfers were taxed at a flat rate, there would be no marriage penalties. Specifically, the penalties are a result of policymakers’ efforts to achieve the goal of progressivity—giving greater tax and welfare benefits to those with lower income—while trying to keep down program costs. Thus benefits in transfer programs fall, sometimes steeply, as households earn more income. Combining the direct tax rate in the tax code and the benefit reduction rates in the transfer system can result in extremely high effective marginal tax rates for many low- to moderate-income families—rates far higher than those of families earning over $90,000. These high rates lead to the marriage penalties because additional income brought into a household by marriage thus causes other benefits to be reduced or lost altogether. In extreme cases, households can lose a dollar or more for every dollar earned.

In recent years lawmakers have begun to try to reduce marriage penalties, primarily by reforming welfare and cutting taxes, but huge penalties remain. The authors offer several options for reducing or eliminating the marriage penalty and recommend two in particular. The first is to set a maximum marginal tax rate for lower-income individuals, similar to the maximum rate set for highest-income individuals. The second is to provide individual wage subsidies to lower-income earners, so that such workers who marry can combine their income with that of their spouse without incurring penalties.

www.futureofchildren.org

Adam Carasso is a research associate at the Urban Institute. C. Eugene Steuerle is a senior fellow at the Urban Institute and a co-director of the Urban-Brookings Tax Policy Center. A version of this paper was presented at the 26th Annual APPAM Research Conference in Atlanta, Georgia.
Public controversy over whether it is appropriate for state and federal governments to promote marriage overlooks a simple truth: government is already heavily entrenched in the institution of marriage. While debates swirl over whether to spend a few hundred million public dollars on marriage promotion and counseling, hundreds of billions of dollars in government tax and social welfare programs are at stake for tens of millions of couples, depending on whether they are married.¹

The primary focus of this article is marriage penalties in tax and social welfare programs for low- to moderate-income households with working parents and children. But the penalties and subsidies within government tax and transfer programs affect all Americans. When two very-low-earning parents marry and receive more in earned income tax credit (EITC) than they did before they were married, they are receiving a marriage subsidy. When, at retirement, the nonworking spouse in a well-to-do couple receives Social Security spousal and survivors benefits just because she is married (while the working single mother does not), she too is receiving a marriage subsidy. When a single parent earning the minimum wage marries another worker at minimum wage and loses several thousand dollars of food stamp benefits, he incurs a marriage penalty. When, say, a police officer marries a nurse making similar income, placing both in a higher tax bracket, where they owe several thousand dollars more in taxes, he too incurs a marriage penalty. Often couples face simultaneous subsidies and penalties. For instance, the couple that sees their EITC benefit double because they marry might simultaneously see their welfare or food stamp benefits diminish or disappear. This article steers readers through this policy maze, although its emphasis is on low-income men and women when they are younger, have children, and participate in programs likely to bring about penalties, rather than when they are older, their children have left home, and Social Security often provides bonuses.²

How the Penalties and Subsidies Work
Various tax and transfer programs act singly and in concert to penalize or subsidize marriage, depending on the mix of income and the number of eligible children two people bring to a marriage. On the tax front, particularly important provisions that can result in marriage penalties or subsidies are the earned income tax credit and the child tax credit.

To see how a marriage tax subsidy might work, consider the child tax credit. Working parents must earn more than $10,750 to receive any credit. The credit pays 10 cents for each dollar more that a working parent earns, up to a maximum of $1,000 for each child. A single mother with one child who earns $10,750 receives no child credit. But if she marries a childless man who earns $6,250, so that together they earn $17,000, the couple receives $625 as a subsidy for getting married—10 cents for each dollar more than $10,750.

The EITC can provide both subsidies and penalties. A single parent with two children who earns $15,000 enjoys an EITC benefit of about $4,100. The credit decreases by 21.06 cents for every dollar a married couple earns above $15,040. Based on that phase-out rate, if the single parent marries someone earning $10,000, for a combined income of $25,000, the EITC benefit will drop to about $2,200. The couple faces a marriage tax penalty of $4,100 minus $2,200, or $1,900.
On the transfer front, important programs with marriage penalties (but fewer bonuses) include Temporary Assistance for Needy Families (TANF), food stamps, housing assistance, child care, and Medicaid—all means-tested programs for which citizens cannot qualify unless their income (and resources and assets) is below a certain level. How much transfer program benefits are worth and the rate at which their value falls as family income rises vary by state, by family size, by the age of the children, by additional factors like the cost of rent and child care, and by what other transfer programs the family may be enrolled in. As a simple example, consider a mother of two children in Pennsylvania who earns $20,000 and qualifies for Medicaid (with an insurance value estimated at $3,424). If she marries someone making just $6,000, resulting in a combined income of $26,000, her children lose their Medicaid. Unlike the child credit and EITC, most transfer programs for low-income families with children contain mainly marriage penalties—the additional income introduced by a spouse generally reduces or even ends benefits received before the marriage. Only later in life, as noted, does Social Security often provide marriage subsidies through spousal or survivor benefits that are triggered merely by marriage and require no additional contribution by the worker.

Citizens pay an overall marriage penalty when their combined social welfare benefits less taxes are lower as a married couple than as two single individuals. As a simple example, a single parent with two children earning $16,000 marries someone earning $10,000, thereby losing more in food stamps, Medicaid, and EITC than she gains in child tax credits. A marriage subsidy is the reverse—the couple receives more from the government (or pays less) if they marry than if they remain single. Consider, for example, a non-working mother with two children in Pennsylvania on TANF who marries someone without children who earns $5,000. Their marriage bonus derives mainly from an increase in EITC of about $2,000 and no loss of TANF or Medicaid benefits.

**Penalties and Subsidies: A Policy Accident**

Today, most households with children who earn low or moderate incomes (say, under $40,000) are significantly penalized for getting married. The issue is seldom engaged consistently or rigorously by elected officials, primarily because they typically enact programs piecemeal, with little coordination or thought to how they affect married couples. Congress enacted Social Security, Aid to Families with Dependent Children (AFDC), and various housing programs in 1935; the Food Stamp Act in 1964; Medicare and Medicaid in 1965; the EITC in 1975 (and subsequent expansions of the credit in 1987, 1990, 1993, and 2001); the Child Care Development Block Grant in 1990; welfare reform in 1996 (which replaced AFDC with TANF); the State Children’s Health Insurance Program (SCHIP) in 1997; and the child tax credit in 1997 (expanded and made refundable in 2001). The list could go on and on. Each program, as well as its subsequent reforms, was the product of unique social forces and was designed to address a specific social need. Had they all been enacted as one comprehensive program, lawmakers might have been more inclined to coordinate and focus on the marriage penalties, subsidies, and incentives. But because the programs were put in place one by one, over many years, lawmakers who now wish to rationalize the way government treats marriage must radically restructure much of the modern social welfare state.
Marriage penalties or subsidies are assessed primarily for taking wedding vows, not for living together with another adult. Those who do not feel morally compelled to swear fidelity in religious or public ceremonies for the most part do not suffer the penalties. For instance, for the EITC, the tax system’s concern is whoever financially maintains the house in which the child stays for more than half the year. The IRS does not generally go to the household to determine how many days some other adult (who may contribute to the household’s income) is living there if there is no marriage certificate.

In the transfer system, many program benefits are determined by household size. By law, these programs would treat a couple who admits to cohabiting (for an appreciable period of time) just as they treat a couple who marries. In practice, however, administrators seldom go knocking to check on cohabitation, often cannot find proof of round-the-clock cohabitation, as opposed to several days or nights a week, and are unlikely to require joint filing unless the couple has been together a long time. There are some exceptions, as when welfare officials attempt to assess whether someone is living in a home on a regular or fairly permanent basis to determine household status or when a state attempts to establish a child support order against the noncustodial parent and requires he provide an address. But we know of no study that has examined in depth the extent of such checks across EITC, food stamps, Medicaid, TANF, and so on. For our purposes, the distinction between marriage and acknowledged cohabiting often makes little difference with respect to how families are treated under federal social welfare programs. When officials determine that a couple is cohabiting, what we describe as “marriage penalties” become “marriage and admitted cohabitation penalties.” Under the tax system, married and cohabiting couples are treated differently, whereas under the transfer system, the distinction is less clear and may depend, in some cases, on the biological relationship between the father and child and whether the couple is candid about their relationship. Regardless of the rules of the program and the legal status of the cohabiting couple in the transfer system, in practice, cohabiting parents can avoid the marriage penalty more easily than can married parents.

What Research Has—and Hasn’t—Found

Although there is a steadily growing body of research on how marriage affects the economic well-being of households with children, few studies attempt to measure the size of penalties and subsidies for marriage arising from all public programs considered together. The topic is admittedly complex, but in our view researchers have not fully come to grips with the long-term implications for the nation of policies that place large penalties on marriage for a considerable share of its poorer households. A first step is to measure how large the penalties are. This study provides the most comprehensive picture to date.
Why should we care about marriage in the first place? Two articles in this volume, one by Adam Thomas and Isabel Sawhill and the other by Paul Amato, survey research on the numerous benefits, both economic and noneconomic, that marriage provides. Many findings imply that “intrinsic” benefits accrue to the spouses and children in a marriage regardless of a couple’s employment and education. Some researchers follow changes in families’ economic well-being resulting from transitions into and out of marriage, although few try to measure formally the financial incentives to exchange or keep marriage vows for families participating in the patchwork of U.S. tax and transfer programs. Other researchers address separately the effects of the welfare system and the tax system on a couple’s decision to marry or divorce. But they rarely consider taxes along with welfare benefits. On the welfare side, Robert Moffitt reviews sixty-eight studies on the effect of AFDC on marriage and fertility. Most, he notes, show that the old AFDC program discouraged marriage to some degree, but a sizable minority find no effect at all. Marianne Bitler and her colleagues examine vital statistics data on marriage and divorce and find that the 1996 welfare reform law, which compelled most single heads of households to work and therefore earn some income, reduced the incentives for these single mothers to marry by giving them greater financial independence.

Research on taxes, meanwhile, has paid increasing attention to the situation of single parents who file as head of household. These parents owe less tax than they would filing as singles because of the special tax-advantaged nature of this filing status, but they may forfeit this advantage if they marry. Although the “married, filing jointly” status is even more favorable than the head-of-household status at the same level of income, households with only one earner can lose any gains made from moving to the married status if the two incomes pooled together put the couple in a higher tax bracket. Researchers have also studied how marriage tax penalties have changed over the years and whether these changes have influenced people’s decisions to marry or divorce. James Alm and Leslie Whittington find that tax penalties slightly discourage marriage, while David Sjodquist and Mary Beth Walker find no significant effect. That the findings are inconclusive is not surprising, because the tax penalty or subsidy is very sensitive to the mix of income two spouses bring to a marriage.

Measuring empirically the behavioral effects of specific marriage penalties or subsidies is equally daunting. Some quantitative and ethnographic research suggests that people’s decisions to marry or divorce are governed much more by such considerations as a potential spouse’s suitability as a partner and as a parent, the desire for a fulfilling relationship, and the risk of infidelity, than by the tax and transfer program consequences. Understanding how the raft of benefits a family might apply for responds to changes in family income or marital status is anything but straightforward. Furthermore, researchers have great difficulty examining group effects that may unfold over time. For example, if incentives change the behavior of a few households, and other households follow suit, then a group effect like “copycat” behavior may wind up playing a bigger role than the actual incentives.

Finally, examining whether couples figure out marriage penalties before they marry offers only limited evidence about the effect of the penalties on the decision to marry. People may
react to incentives even when they do not calculate them, as when partners choose to cohabit or people remain single because they simply observe that unmarried couples have a higher standard of living than those who marry—without necessarily understanding how rules in public programs create this result.

Reducing Marriage Penalties: A Beginning

In recent years lawmakers have tried to reduce marriage penalties in various ways, primarily by reforming welfare and cutting taxes. Although the penalties and subsidies that remain are huge, at least policymakers have taken note of the problem and taken steps to address it.

In 1996 Congress replaced AFDC with TANF, directly linking a family’s continued receipt of cash assistance to greater work effort by parents. The new law set time limits on how long enrolled families could receive cash assistance. It also strengthened work requirements, increased the income a family can earn without losing cash assistance, and established financial sanctions for families failing to meet work requirements. Many analysts have written about the modest tendency of both AFDC and TANF to discourage marriage, and the jury is still out on whether welfare reform has reduced the marriage penalty. To the extent that fewer families are on welfare, fewer face its marriage penalties. For former welfare recipients who are now working and receiving the EITC, however, marriage penalties may be linked with the EITC, rather than TANF.

Marriage penalties and subsidies have been part of the U.S. tax code since 1948, when the nation moved from a system of taxation based on individuals to one based on marital status. The “married, filing jointly” filing status—which effectively splits a couple’s income evenly between spouses for tax purposes—was added to hold marriage harmless relative to being single and to comport with a growing number of states that had passed community property laws. Because few households at that time had two working parents, however, the new filing status usually resulted in bonuses for married couples. In 1969 Congress put in place standard deductions and tax brackets for married couples that were no longer twice as wide as those for singles, thus creating marriage penalties for two-earner couples whose incomes tended to be evenly split. This practice, and the marriage penalties it produced, continued, although penalties were sharply reduced by the 1986 tax reform.

A 1998 report by the Congressional Budget Office estimated that in 1999, 52 percent of married couples would enjoy marriage bonuses under the tax system, while 43 percent would incur penalties. The report went on to say that bonuses would total about $43 billion in 1999, while penalties would sum to $32 billion.

The enactment of President George W. Bush’s requested tax cuts in 2001 significantly reduced marriage penalties (or increased marriage subsidies) for most middle-income families that filed taxes. A suite of provisions, including a small increase in the income level at which a couple would begin to lose EITC benefits, was advertised as marriage penalty relief. Yet the most relief for lower- to middle-income families came from raising the child credit’s value from $500 to $1,000 per child and making it partially refundable. For higher-income families, marriage bonuses were increased by reverting back toward “income splitting” in the bracket structure, as in the 1948 tax law.
The succeeding 2003 and 2004 tax bills largely accelerated the implementation of the 2001 tax cut. They put most of the marriage penalty relief provisions into effect more quickly, accelerated the increase in the child credit from $600 to $1,000 to 2003, and raised its refundability rate from 10 percent to 15 percent for 2004. For many middle- and upper-income households, whether or not they had children, the bill also reduced marriage penalties by adjusting the brackets in which different tax rates began. The Joint Committee on Taxation (JTC) has forecast the cumulative cost of marriage-penalty-directed tax cuts in these three tax bills over the period 2001–11 to be $114 billion. But in 2004, 81 percent of this marriage penalty relief was concentrated on couples earning above $75,000 (and most of this on households earning just between $100,000 and $200,000), who are not our primary focus—and much also went to increase marriage bonuses rather than simply reduce penalties. Of more interest here, the expansion of the child tax credit lowered penalties or boosted bonuses, even though this was not its primary intent—and is not captured in the JCT $114 billion cost estimate of marriage penalty relief. Still, the bill shows that elected officials at times are willing to spend substantial sums to reduce marriage penalties.

How Marriage Penalties and Subsidies Arise

Lawmakers rarely intend to create marriage penalties; even subsidies are often accidental. Two conditions are necessary to cause marriage penalties and subsidies, and neither is sufficient by itself. The first condition is tax rates that vary based on income. The second is joint filing by married couples for benefits or taxes. Both characterize the U.S. tax code.

The effect of the first condition, variable tax rates, is often exacerbated by government transfer programs that are also based on joint filing. During the past several decades, policymakers have pursued the dual objectives of progressivity—giving greater tax and welfare benefits to those with lower incomes—and cost containment. As a result, programs like the earned income tax credit or food stamps restrict benefits to lower-income citizens by reducing or “phasing out” the benefits at steep rates as households earn more income (see box on page 164 for an example).

In 2004, 81 percent of the marriage penalty relief was concentrated on couples earning above $75,000 (and most of this on households earning just between $100,000 and $200,000).
What Happens When Transfer Benefits Phase In and Out

The earned income tax credit “phases in” at 40 cents for each dollar of earned income up to $10,750, for a maximum benefit of $4,300 in tax year 2004. If Martha has two children and earns $5,000, she receives 40 percent of her earnings (or $2,000) in EITC. Suppose she marries Robert, who also earns $5,000 and has no children of his own, and they file a joint tax return. Together, they would have $10,000 in earned income, so they receive an EITC of $4,000, for a marriage subsidy of $2,000.

For incomes between $10,750 and $14,040 ($15,040 if a couple are married), a single parent (or married couple) neither receives additional EITC benefits for additional dollars of earnings nor loses any benefit. But as soon as earnings rise above that higher level, the EITC decreases, or “phases out,” by 21.06 cents for every extra dollar earned by the household unit. The credit disappears completely when incomes exceed $34,458 ($35,458 for married couples).

Suppose Martha earns $14,040 and enjoys the full EITC benefit of $4,300. Now, suppose she marries Robert, who has no children. If Robert earns $1,000, they have a combined income of $15,040; they lose no EITC benefits, because they are right at the “phase-out threshold” for married couples. But if Robert earns $10,000, boosting the couple’s earned income total to $24,040, their EITC benefit drops by $1,895, from $4,300 to $2,405. Martha and Robert are being penalized 21.06 cents for every dollar they earn over $15,040.

Now suppose Robert earns $22,000, putting him and Martha at $36,000 in total earned income. Because the EITC has phased out completely by $35,458 for married couples, Martha and Robert now receive no EITC for Martha’s children. By marrying, they have been penalized $4,300 in EITC benefits—money they would have enjoyed had they simply cohabited or lived separately.

Note that the levels and rates given above apply to all households with two or more children. For households with just one child, the benefit amount and the phase-in and phase-out rates are less.

21.06 percent EITC phase-out rate, for a total rate of 31.06 percent.28 (For this example, we are ignoring many other taxes and benefit reductions, such as Social Security tax or food stamps.) Thus, for the income range over which a given benefit phases out, the effective marginal tax rate bumps up by the phase-out rate until the benefit has fallen to zero. When our single tax filer’s income (or if she marries, her and her husband’s combined income) exceeds about $35,000, her EITC benefit is gone and the 21.06 percent phase-out rate no longer applies, so her effective marginal rate then drops by 21.06 percentage points.

Although one may not typically think of it in this light, the loss of means-tested transfer benefits as earnings increase affects a household in much the same way as higher direct tax rates do—both are losses of income. Indeed, economists commonly apply the term “tax rates” to transfer programs to identify how much benefit is lost (effectively taxed away) as a family’s income rises. This, by the
way, is not a comment on the fairness of benefit phase-outs. Some observers believe that there is no entitlement to such benefits, and therefore that benefit reductions are different on equity grounds from direct taxes, which take away what one has earned rather than what one has received as a transfer. But in terms of incentives and size of penalties the issue remains, regardless of the fairness of benefit phase-outs.

Benefits from some programs, like Medicaid and the State Children’s Health Insurance Program (SCHIP), do not phase out gradually but instead fall swiftly or end altogether as soon as a household’s income exceeds some dollar threshold. In these cases, receiving one more dollar of earnings can strip a household of several thousand dollars of benefits.

The effective marginal tax rate—the rate created by steep benefit phase-out rates combined with graduated income tax rates—moves up and down a lot as income increases, as evidenced by the example above, but it is usually highest for low- to moderate-income families. This reality runs counter to the notion that marginal rates rise progressively with income, as one would be led to believe by looking only at the statutory rate schedule in the income tax.

Note that these variable tax rates do not by themselves penalize marriage. A second, simultaneous condition is necessary to create marriage penalties and bonuses—joint filing by married couples for taxes or benefits. Policymakers often look to the household unit, or joint tax return income, rather than to each individual’s income separately to measure the need for transfer benefits or the ability to pay taxes. Their aim is to treat households with equal incomes equally, but in a system with variable rates, individuals with equal incomes will then not be treated equally. If graduated or variable tax rates were accompanied by individual filing, there would be no marriage penalties. Marriage would have no effect on any benefit received or tax paid by the individual. Alternatively, if everything were taxed at a flat rate (including zero, as in the case of a universal grant that did not phase out) there would also be no marriage penalties.

Mapping the High Effective Marginal Tax Rates

Although our ultimate focus remains on penalties and subsidies related to marriage, it is best to begin by examining the tax situation of selected single parents before moving on, in the next section, to see in detail how the high tax rates contribute to marriage penalties when a single parent marries. Figure 1 tracks select tax and transfer benefits for a single head of household with two children, showing how these benefits generally decline as household income increases. The exact size of benefits and the rate at which they decline depend on the mix of programs in which the family is enrolled and the way these programs interact with one another.

Panel 1 includes federal income taxes, exemptions, and credits, employer and employee portions of the Social Security tax, and state taxes, plus food stamps, Medicaid, and SCHIP. A focus on this set of programs is important because, in theory, every household with children is eligible for these programs if its income is low enough. The benefits are generally not restricted by waiting lists and are universally available as long as recipients meet certain eligibility criteria, which can vary by state. In a sense, then, the high tax rates levied by these programs apply to all households except those with annual earned incomes higher than $40,000, which
Figure 1. Select Tax and Transfer Benefits for a Head of Household with Two Children in Tax Year 2004

Panel 1. Tax system plus food stamps, Medicaid, and SCHIP

Panel 2. Plus federal public housing, TANF, child care subsidies, and WIC

Source: Authors’ calculations, Urban Institute (2005).

Note: SCHIP is the State Children’s Health Insurance Program; TANF is Temporary Assistance to Needy Families; EITC is the earned income tax credit; WIC is the Special Supplemental Nutrition Program for Women, Infants, and Children. The children are assumed to be aged two and five. Tax calculations include the alternative minimum tax and assumptions on itemized deductions. Transfer programs apply rules for Pennsylvania, which is the median TANF benefit state. Maximum annual child care costs are assumed to be $5,000. Note that in panel 2, the adults in a family previously on TANF remain eligible for Medicaid up to 185 percent of poverty (for up to twelve months after leaving TANF).
have moved beyond the income cutoffs for all or most transfer programs. Put in terms of panel 1, these latter households have moved to the right along the horizontal axis beyond, first, the high-benefit regime (which applies to earnings of roughly $0 to $10,000), and then, the high-tax-rate regime (which applies to incomes of roughly $10,000 to $40,000).

Panel 2 includes the same programs as panel 1 but also assumes the single-parent family of three is receiving welfare cash assistance (TANF), housing assistance, and child care benefits (direct expenditures for child care from the Child Care and Development Fund or deductions through the tax system from the Child and Dependent Care Tax Credit). As a general rule, these additional programs are not universal, in contrast to those in panel 1. Rather, they are parceled out either through time limits for years of eligibility or through queues as to who may participate (the modest child and dependent care tax credit is not queued, but those claiming it must have tax liability to offset). Households are much less likely to benefit from the programs in panel 2 than those in panel 1.

In both panels, the single-parent family receives the most benefits between about $5,000 and $10,000 of earnings—mostly because the EITC is fully phased in by that earnings level, while most other benefits are either still phasing in or have not yet phased out. Benefits drop off steeply as earnings exceed $20,000.

Figure 2 compares the average effective marginal tax rates of various low- to middle-income (averaging between $10,000 and $40,000, including benefits) single-parent families with two young children with the rate of more well-to-do families. The marginal tax rate in the first bar—35.9 percent—is based simply on federal and state direct taxes, including Social Security and the...
EITC. The rate rises appreciably as the family enrolls in additional transfer programs in bars 2 and 3. For a family enrolled in more universal, non-wait-listed programs like food stamps, Medicaid, and SCHIP, the average effective marginal tax rate would be 58.8 percent. Enrolling the family in additional wait-listed programs, like housing assistance and child care, ratchets up that rate to 88.6 percent.35 The fourth bar, by way of comparison, shows that the average effective marginal rate affecting families (lumping one- and two-parent families together) earning $90,000 or more is 33.2 percent—lower than that applying to all the other groupings of lower-earning families.

From High Tax Rates to Marriage Penalties
The extremely high effective marginal tax rates faced by low- to moderate-income adults with children, combined with the current U.S. practice of assessing taxes and benefits on the basis of household rather than individual income, lead directly to the marriage penalties. What triggers the penalty is that the earnings of one spouse are taxed at a different rate simply because of marriage. In a very common example, a man facing combined income and Social Security tax rates of about 30 cents for every additional dollar earned discovers that upon marrying a woman with EITC and food stamp benefits, the introduction of his income into the household reduces those benefits, and also causes her to lose eligibility for Medicaid.

Figure 3 graphs the dollar amounts of penalties and subsidies that a single earner and a single-parent head of household with two children would face if they were to marry. (The penalties are much higher in the less common example when two single people, both with children, marry.) Three scenarios are presented, showing families with household earnings of $10,000, $20,000, and $30,000 a year. To take into account the various ways in which those earnings can be distributed between the couple, each scenario shows the single parent, as the secondary earner, earning between 0 percent and 100 percent (in 10 percent increments) of the couple’s total income.36 Generally, as the figure shows, when spouses have similar earnings, penalties are higher (subsidies are lower). When one spouse earns significantly more than the other, penalties are lower (subsidies are higher).37 In the figure, the darker curve shows the marriage penalties in the tax system alone; the lighter curve shows combined penalties in the tax system and in the transfer system programs of food stamps, Medicaid, and SCHIP. Because these three programs, as noted, are almost universally available, effectively these penalties are faced by all families in these income ranges unless they fail to apply for the benefits. We have not included an even wider set of programs such as housing and TANF, where the penalties become very large.

As the figure shows, in the tax system by itself low-income families generally enjoy marriage subsidies, regardless of how earnings are divided, thanks largely to the generous phase-in of the EITC, which pays 40 cents for every dollar earned up to $10,750 for households with two children.38 At modest earnings of $20,000 and above, however, both tax and transfer marriage penalties loom large, primarily because of the high phase-out of the EITC and the decline of food stamps, which fall several hundred dollars for every additional thousand dollars of earnings. For families not on TANF, as in this example, Medicaid becomes unavailable to parents after around $5,000 of income, though children are covered as long as parental income is rel-
Figure 3. Marriage Penalties and Subsidies in Select Federal Tax and Transfer Programs for a Married Couple with Two Children, Tax Year 2004

Panel 1. Household income of $10,000
Penalty/(subsidy) (thousands of dollars)

<table>
<thead>
<tr>
<th>Penalty/(subsidy) (thousands of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
</tr>
<tr>
<td>4</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>0</td>
</tr>
<tr>
<td>(2)</td>
</tr>
<tr>
<td>(4)</td>
</tr>
<tr>
<td>(6)</td>
</tr>
</tbody>
</table>

Secondary earner’s wages (thousands of dollars)

Panel 2. Household income of $20,000
Penalty/(subsidy) (thousands of dollars)

<table>
<thead>
<tr>
<th>Penalty/(subsidy) (thousands of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
</tr>
<tr>
<td>4</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>0</td>
</tr>
<tr>
<td>(2)</td>
</tr>
<tr>
<td>(4)</td>
</tr>
<tr>
<td>(6)</td>
</tr>
<tr>
<td>(8)</td>
</tr>
</tbody>
</table>

Secondary earner’s wages (thousands of dollars)

Panel 3. Household income of $30,000
Penalty/(subsidy) (thousands of dollars)

<table>
<thead>
<tr>
<th>Penalty/(subsidy) (thousands of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
</tr>
<tr>
<td>4</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>0</td>
</tr>
<tr>
<td>(2)</td>
</tr>
<tr>
<td>(4)</td>
</tr>
<tr>
<td>(6)</td>
</tr>
</tbody>
</table>

Secondary earner’s wages (thousands of dollars)

Source: See figure 1.

Note: Calculations assume that a single earner (the primary earner) marries a head of household with two children (the secondary earner). The earnings of the secondary earner range from 0 to 100 percent of household income in each example. The primary earner earns the balance and was a single filer without children before marriage. Marriage penalties and subsidies include the effects of Social Security taxes (both employer and employee portions) and state income taxes.
atively low. SCHIP, meanwhile, replaces Medicaid’s coverage of children at incomes between 185 and 235 percent of poverty (that is, between $36,000 and $45,000 for a family of four) in Pennsylvania. In other words, in Pennsylvania, these health programs contribute substantially to marriage penalties, first, at very low incomes (below $10,000), and then again, at moderate incomes (above $36,000).39

Possibilities for Reform

Given the hundreds of billions of dollars in marriage penalties and subsidies processed each year through the nation’s social welfare system, the prospects for reform may seem remote. But as recent tax legislation makes clear, elected officials are occasionally prepared to take sweeping action—even if their attention so far has focused mainly on those with incomes above the median.

We offer four options for reform. The first two, in our opinion, deserve special consideration as newer, although untried, approaches. The other two options have been applied in specific circumstances, but both would require major adjustments in benefit and tax structures if they were to be carried out on a wider scale. A combination of these approaches, nonetheless, could be used to lessen—and for many, remove—current marriage penalties.

A Maximum Tax Rate for Low- and Moderate-Income Families

A primary focus of self-labeled “supply-side” economists for the past thirty years has been to set a maximum marginal tax rate for higher-income individuals. That maximum rate, ranging from about 28 percent to 39 percent (and down from 70 percent in 1980) was incorporated into tax reform during both the early 1980s and the early 2000s, although proponents had pushed for rates as low as 20 to 25 percent. Yet the maximum effective marginal tax rate for lower- to moderate-income households is often far higher. As noted, single people typically may find their 30 percent marginal tax rate jumping to 50, 60, 80, or even 100 percent when they marry someone with children. To implement a maximum rate would require coordination and one-stop shopping for many of the nation’s social welfare programs—but this action would go far toward reducing marriage penalties.

Individual Wage Subsidies

Although the EITC is sometimes considered so, it is not a true wage subsidy. Many workers with very low wages become ineligible for the EITC when their income is combined with that of a spouse. A wage subsidy based on individual wages, whether hourly or annual, would avoid this problem. Recent comments by First Lady Laura Bush, among others, have focused renewed attention on the plight of many men who can receive costly “public support” only if they break the law and enter the corrections system. Otherwise, most of the contact these men have with the social welfare system involves facing huge marriage penalties. Rather than being family breadwinners, many find themselves able to help their children financially only by moving out or never marrying. Individual wage subsidies would help make it possible for a low-wage man or woman to marry someone with children without losing substantial income and welfare.

Universal Programs

A universal program or tax credit—one that goes to households with children without diminution of benefits regardless of marital status or income—clearly would not create a marriage penalty. Many government spending programs, such as public education and
Medicare, fall into this category because they are not means tested. The recent adoption of a more universal child credit in the tax code reduced marriage penalties in exactly this manner.

**Mandatory Individual Filing or Choice of Filing**

If married individuals were either required or given the option to file as single individuals, they could avoid marriage penalties. Many other nations, such as Canada, Australia, Italy, and Japan, allow or require individual filing for married couples for income tax purposes.

**Conclusion**

For several decades now, policymakers have created public tax and transfer programs with little if any attention to the sometimes severe marriage penalties that they inadvertently impose. The expanded public subsidies thus put in place by lawmakers came at the expense of higher effective marginal tax rates, as program benefits often had to be phased out beginning at fairly low incomes to keep overall program costs in check. The combined effective marginal tax rates from these phase-outs and from regular taxes are very high—sometimes causing households to lose a dollar or more for every dollar earned and severely penalizing marriage. In aggregate, couples today face hundreds of billions of dollars in increased taxes or reduced benefits if they marry. Cohabiting—that is, not getting married—has become the tax shelter of the poor.

These developments are in no small part the consequence of a half-century of social policy enactments of roughly similar design. Liberals wishing to keep programs very progressive and conservatives wishing to keep budget costs low have together put a substantial portion of household subsidies and assistance onto this platform.

These penalties can be reduced in various ways. Most promising, in our view, is to establish a combined maximum marginal tax rate for low- and moderate-income households similar to the rates applying to the richest individuals in society. Another innovative strategy would be to provide a wage subsidy on an individual rather than a family basis for low-wage workers. Two other approaches, both of which have already been tried successfully on a smaller scale, would be to make some programs more universal, as with the child credit and public education, and to move toward mandatory or optional individual filing for benefits and taxes.

In recent years, couples in the United States have increasingly regarded marriage as optional, one among many ways of creating a household. This declining regard for marriage calls into question government’s continued use of marriage vows as the primary mechanism by which to enforce household filing for benefits and to raise taxes or lower benefits. Whether Americans’ changing views on marriage eventually lead to the radical restructuring required to reduce the very high level of marriage penalties facing most low- and moderate-income individuals remains to be seen.
Notes

1. That there could be hundreds of billions of dollars each year in marriage penalties and bonuses should not be surprising. Given that there were more than 112 million households in the United States in 2003, according to the Census Bureau, and that most ways a couple could divide up their income would result in hundreds and usually thousands of dollars of marriage penalties or bonuses (often in multiple tax and transfer programs), federal programs entail hundreds of billions of dollars in penalties and bonuses.

2. We will refer to marriage/subsidies or bonuses; the two words are interchangeable.

3. Because transfer program eligibility and benefit rules are often state specific, we must choose one state as an example on which to run our simulations. We choose Pennsylvania, because the monthly TANF (welfare) benefits it provides are near or at the national median and also because its transfer programs' rules tend to be less complex than those of other states.

4. If he earned just $5,000, the couple would still be eligible, but would be at the very edge of Medicaid's income cutoff. In transfer programs like Medicaid, the benefit reduction schedule compensates somewhat for larger families—as a new person (the husband) joins the family, the income cutoffs for Medicaid benefit eligibility increase, but only slightly.

5. We will refer to TANF also as welfare.


8. See, for example, Gregory Acs and Sandi Nelson, "Should We Get Married in the Morning? A Profile of Cohabiting Couples with Children" (Washington: Urban Institute, March 2004); Paul R. Amato's article in this volume; and Robert I. Lerman, "Impacts of Marital Status and Parental Presence on the Material Hardship of Families with Children," paper prepared for the U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation (July 2002).


13. Those parents filing as head of household can claim a larger standard deduction and also benefit from a wider tax bracket than those who file as single.


15. See the article by Kathryn Edin and Joanna Reed in this volume.

16. Edin’s ethnographic research seems to show that low-income households are fairly familiar with marriage penalties and their ramifications in the EITC. More moderate income households also display knowledge about penalties in education programs like the Pell Grant. However, the general understanding of marriage penalties in other transfer programs has not been widely examined.


18. For a detailed history of marriage tax penalties, as well as family-related tax provisions, see Michael J. McIntyre and C. Eugene Steuerle, “Federal Tax Reform: A Family Perspective,” prepared for the Finance Project (Washington: The Finance Project, July 1996); and James Alm and Mikhail I. Melnik, “Taxing the ‘Family’ in the Individual Income Tax” (Andrew Young School of Policy Studies, Georgia State University, July 2004). Alm and Melnik also compare, in detail, how family taxation is treated in the United States with its treatment in other developed countries.

19. See Congressional Budget Office, “Update of Marriage Penalties and Bonuses” (September 1998); and Congressional Budget Office, “For Better or for Worse: Marriage and the Federal Income Tax” (June 1997). Note, though, that aggregate estimates of bonuses and penalties fluctuate a lot from year to year, for a variety of reasons. As of the writing of this article, CBO has not published an update of the paper.


21. Where increases in penalties or decreases in subsidies do occur, they are fairly small. That is, the winners tend to win a lot, while the losers lose little.


23. About 35 million married couples were affected by the legislation. Estimates from the Urban-Brookings Tax Microsimulation Model (version 0305-1).


26. This is calculated before tax credits are applied.

27. Economists believe, though, that it is the marginal tax rate—the rate applying to an individual's next dollar of earnings—that affects most that individual's incentives to work or marry. See Forman, Carasso, and Saleem, “Designing a Work-Friendly Tax System” (see note 25).

28. Note that this is a simple example. We have not included the phase-in of the child tax credit that would lower her effective marginal tax rate (because this credit is still phasing in at her salary level) or her Social Security payroll taxes, which would raise it again.

29. While SCHIP is not an entitlement program, except where it is run as a Medicaid expansion (twelve states only), families who meet the eligibility requirements are rarely turned away. While the economic downturn that began in 2001 has hurt state budgets and challenged states’ financing of current benefits, few states have responded with significant—and permanent—retrenchments in either benefit levels or eligibility. Pennsylvania's SCHIP program is run separately from its Medicaid program but has shown consistent enrollment numbers over the past several years, and the state has not resorted to wait lists or enrollment caps. See Vernon K. Smith, David M. Rousseau, and Molly O'Malley, “SCHIP Program Enrollment: December 2003 Update” (Menlo Park, Calif.: Kaiser Commission on Medicaid and the Uninsured, July 2004).

30. Child support is sometimes required from biological noncustodial parents. That money—except for $50 a month (in Pennsylvania)—effectively goes to the state’s TANF agency as recompense for welfare benefits. See Primus and Beeson, “Safety Net Programs” (see note 6). In that case, the main effect is the same as taking away some of the TANF benefit, and thereby reducing the marriage penalties that can arise from TANF. See Marcie Carlson and others, “The Effects of Welfare and Child Support Policies in Union Formation,” The Fragile Families and Child Wellbeing Study, Working Paper 02-10-FF (Center for Research on Child Wellbeing, Princeton University, June 2004).

31. Although the child and dependent care tax credit is available in theory to anyone filing income tax forms, in practice, filers would need to owe tax to make use of the credit and to have child care expenses they can readily claim. That is why this credit is included in panel 2 rather than panel 1.

32. This example still omits some income-conditioned programs, such as school lunch and a variety of forms of college aid. Participation in multiple programs (say, four or more), although rare for the general low-income population, is not so rare for single-parent households. See Stephen D. Holt, “Making Work Really Pay: Income Support and Marginal Effective Tax Rates among Low-Income Working Households” (Holt &
Associates Solutions, presented to the American Tax Policy Institute, March 2005). This monograph uses a data set of 3.2 million household records in Wisconsin in 2000, which matches benefits receipt information with unemployment insurance wage records, and state income tax records. The paper presents comprehensive findings on tax and transfer program participation in Wisconsin for 2000. Holt finds that a quarter of single-parent families with two children earning $18,000 a year or less participated in three tax and transfer programs, while another quarter participated in four programs. Six percent participated in five programs.

33. The maximum amount of benefits received ultimately depends on families’ program eligibility and benefit levels (both of which are highly variable by state), marital status, and the number and age of the children. However, most families will encounter a benefit curve that is high at low incomes and falls off as more income is earned.

34. More details at each income level are available from the authors.

35. Holt, “Making Work Really Pay” (see note 32), reports comparable findings on the level of effective marginal tax rates affecting single parents in his Wisconsin study of program participation in 2000.

36. Data from the Urban Institute’s National Survey of America’s Families for 2002 suggest that 45.2 percent of cohabiting couples include one partner who earns three or more times what the other partner earns. The percentage of such cohabiting families is significantly higher when combined earnings are $30,000 or less.

37. When a person receives health insurance benefits from a job, one should technically add those benefits to the measure of total compensation. For instance, if a household getting Medicaid worth $5,000 loses this when the head takes a job offering $15,000 of cash and $5,000 of health insurance, then that household should be treated as if it earned $20,000 (not $15,000) and then effectively loses $5,000 of benefits. Other adjustments would be necessary in the calculation (for example, the EITC would still be based on $15,000 of earnings, not $20,000), but again the story line would not change much from what is presented here.

38. In their study of potential marriage penalties and bonuses, Gregory Acs and Elaine Maag have a similar finding for their sample of cohabiting couples. (As for marriage penalties and bonuses in total, however, they look only at cohabiting couples as defined in the National Survey of America’s Families and only at penalties and bonuses within the tax system and TANF, whereas we consider the tax system plus a number of transfer programs and their impact on the much larger, additional groups of married or noncohabiting couples.) See Gregory Acs and Elaine Maag, “Irreconcilable Differences? The Conflict between Marriage Promotion Initiatives for Cohabiting Couples with Children and Marriage Penalties within Tax and Transfer Programs,” NSAF Brief, series B, no. B-66 (Washington: Urban Institute, April 2005).

39. As an important aside, asset limits in transfer programs can also cause marriage penalties. These asset limits are often trivial amounts: $1,000 for TANF and $2,000 for food stamps. A single mother who receives these vital program benefits could lose them if she marries someone who has assets in excess of these amounts, even if his earnings are very low.

40. The child credit begins phasing out at 5 cents for every dollar earned above $75,000 (or $110,000 if the couple are married). So the child credit is means tested, but only at a relatively high level.

41. See Alm and Melnik, “Taxing the ‘Family’” (see note 18), for details and many other examples.