

How to Eliminate the Marriage Tax Penalty--Fairly and Simply

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In the winter of this year, the Republican-led Congress passed a measure to reduce the "tax" on marriage. President Clinton vetoed it. The U.S. does have an unfair income tax on two-earner married couples, and the inequity could be eliminated if political leaders were to end their partisanship bickering and make a few simple changes in the federal tax code.

The simplest way to eliminate the marriage tax would be to just tax the earnings of husbands and wives as single individuals. Married couples would still file a joint return, but they would be taxed on their individual earnings and their common income from other sources. The federal tax code had "married but single" separate taxation from the inception of the income tax in 1913 until 1948. Today, if married people file separately, they are penalized with higher tax brackets.

An income tax can be said to be marriage-neutral when the tax on the pooled incomes of married couples equals the combined tax of two single persons with the same incomes. There is a marriage tax if married couples pay more, and a marriage subsidy if they pay less. The marginal tax rate on pooled incomes exceeds the separate rates on individual incomes in modern income-tax systems because marginal tax rates typically increase with income. The severity of the marriage tax is greater when rates rise more rapidly, and also when the earnings between husbands and wives are more equal.

Since the earnings of spouses are usually closer in middle- and lower-income families than in wealthy families, the marriage tax hits families at the lower end especially hard. For example, if the primary earner has a taxable income after deductions and exemptions of \$35,000, and the secondary earner has \$30,000, under the U.S. tax code the couple would pay about one-third more, or an additional \$3,500, than if they were single with the same taxable incomes.

IMPERFECT REMEDIES. Families in which one spouse stays home to care for children do not pay any marriage tax because stay-at-home partners have no earnings to pool. Nor do rising marginal tax rates cause much of a marriage tax in rich families where one spouse's earnings are typically much higher than the other's. However, many educated women with husbands who earn a lot are discouraged from entering the labor force, since their own earnings would be taxed at the high rates of their spouses' earnings.

One obvious way to eliminate the marriage tax is by converting to a flat income tax. If tax rates on all incomes were the same, pooling incomes would not raise the tax burden, even when both spouses have similar incomes. But whatever one's views on a flat tax, the political opposition is formidable and not likely to be overcome soon.

To date, remedies suggested by the Presidential candidates don't completely solve the problem. Vice-President Al Gore has proposed to reduce the marriage tax by widening the exemption for married couples. But this approach won't eliminate the marriage tax because it would benefit one-earner families as much as the two-earner families who pay the tax. Governor George W. Bush's plan to reduce taxes by 10% for two-earner families targets the relevant families, but it does not go far enough, since the tax benefits would not depend on the degree of equality in earnings between spouses.

Separate taxation has several advantages in addition to greater fairness to two-earner families. It would encourage marriages and discourage marital breakups for couples with similar earnings by eliminating their financial gain from remaining single, or from becoming single again through a divorce. Separate taxation of earnings also avoids the need for legislation and court decisions on whether homosexual and patrimonial partnerships should be taxed on their combined or separate earnings.

Marriage generally affects the earnings of both spouses by encouraging one of them to spend more time at home caring for children and engaging in other household activities. Separate taxation does, however, boost the labor-force participation of so-called secondary workers, still mainly married women, by taxing them at the marginal tax rate determined by their earnings rather than at the rate applicable to their earnings pooled with their husbands.

Sweden introduced separate taxation of each spouse's earnings in the 1980s, even though it had an extremely progressive tax system in which marginal tax rates exceeded 90%. The country's conversion to separate taxation is one key factor behind the growth in Sweden of married women in the labor force, now the highest rate in Europe.

Separate taxation of the earnings of husbands and wives achieves marriage-tax neutrality simply and without convoluted tax exemptions and credits for married couples. By contrast, Gore's proposal does not target the unfair treatment of two-earner families, while Bush recommends only partial reform toward neutrality.