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Taxes and Marriage for Cohabiting Parents

By Elaine Maag

Provisions in the federal income tax code that treat married couples as one tax unit and cohabiting couples as two tax units result in both marriage penalties and bonuses. A penalty (bonus) occurs when a couple owes more (less) tax after marriage than they owed before marriage. Many researchers have examined the question of marriage penalties and bonuses using hypothetical families. Indeed, they easily show how a couple can face relatively large penalties or bonuses depending on their assumptions about how income and children in the household are divided between the two partners in the couple.

This analysis uses data from the 2002 National Survey of America's Families (NSAF) to show the extent to which cohabiting parents face marriage penalties and bonuses under 2003 tax law and 2008 tax law, when current marriage-related provisions from the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) phase-in completely. The NSAF data allow an examination of those individuals perhaps closest to marriage — those already living together — without the need to make assumptions about how income is split between the partners in the couple. The NSAF also contains detailed family relationship information, which allows tax liability to be calculated with biological parents keeping their children — rather than making assumptions about how the children are divided in the household. In cases where both members or neither member of the cohabiting couple are biological parents, the higher-earning partner is assumed to provide the majority of support for the child. I calculate federal income tax liability using the Urban Institute Transfer Income Model (TRIM3) under the couple's current cohabiting status and then assuming the couple marries.

Among cohabiting couples with children, slightly more than half (50.7 percent) would pay more in tax as a married couple than they pay as cohabiting individuals under 2003 law, 42 percent would pay less on marriage, and 7.3 percent would experience no change (annual change of less than \$50) in their tax liability. Under 2008 law, 44.1 percent of cohabiting individuals with children would pay more in tax if they were married, and 48.5 percent would pay less in tax if they were married. For

low-income cohabiting couples with children (income less than twice poverty), the odds that a couple will receive a bonus on marriage are higher. Under 2003 income tax law, 63.3 percent of those families would pay less in tax as a married couple — a number that jumps to 74.7 percent under 2008 law. Generally, partners with unequal incomes receive a marriage bonus, and that is more typically the case among low-income households. As seen in table 1, those penalties and bonuses can be substantial.

Marriage Penalties and Bonuses for Cohabiting Couples With Children				
	Bonus		Penalty	
	%	\$ (Average)	%	\$ (Average)
All Couples				
2003 Law	42.0	1,893	50.7	-1,497
2008 Law	48.5	2,236	44.1	-1,513
Low-Income Couples				
2003 Law	63.3	1,949	21.5	-1,428
2008 Law	74.7	2,423	10.5	-1,742

Source: Acs and Maag 2005.

By far, the earned income tax credit (EITC) serves as the largest source of both penalties and bonuses for low-income families. Couples composed of one person with children and low or no earnings typically receive a higher EITC on marriage (because their combined earnings are typically below the EITC thresholds) while couples in which both partners have modest earnings are likely to lose their EITC on marriage because their combined income exceeds that which is eligible for the EITC. EGTRRA provided marriage penalty relief relating to the EITC for some couples by increasing the amount of income a couple could have relative to that of a single parent before the EITC began phasing out.

This analysis includes only the federal income tax system. Penalties and bonuses may be augmented or minimized when state income taxes and transfer programs such as TANF and Medicaid are examined for those individuals participating in the programs. For more information, see Acs and Maag (2005) *Irreconcilable Differences? The Conflict between Marriage Promotion Initiatives for Cohabiting Couples with Children and Marriage Penalties in Tax and Transfer Programs*, The Urban Institute, April.



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