The Widespread Prevalence of Marriage Penalties

Statement of

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Mr. Chairman and members of the Subcommittee:

Thank you for the opportunity to testify today on marriage penalties and bonuses in government programs. Today, literally hundreds of billions of dollars in government taxes and social welfare benefits are at stake for tens of millions of couples depending on whether they are married. While my primary focus today will be on tax and social welfare programs for low- to moderate-income households with working parents and children, penalties and subsidies are also writ large in other programs such as educational grants and Social Security and affect most Americans at different points in their lives.

How the Penalties and Subsidies Work

Citizens pay an overall marriage penalty when their combined social welfare benefits less taxes are lower when they are a married couple than when they are two single individuals. Because marriage is optional, marriage penalties or subsidies are assessed primarily for taking wedding vows, not for living together with other adults (although there are some exceptions).[1]

How much tax and transfer program penalties and bonuses are worth and the rate at which their value falls as family income rises varies 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.

- **Example 1**: **An EITC penalty**. A single parent with two children who earns $15,000 enjoys an EITC benefit of about $4,100. The credit decreases 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, their EITC benefit will drop to about $2,200. They face an EITC marriage tax penalty of $4,100 minus $2,200, or $1,900.

- **Example 2**: **A Medicaid penalty**. A mother of two children in Pennsylvania in 2004 who earns $20,000 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 tax programs like the child credit and EITC, which contain marriage subsidies for some couples, most transfer programs for low-income families with children contain mainly marriage penalties—the additional income introduced by a spouse generally reduces or even cuts off benefits received before the marriage.

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[1] By law, some transfer programs would treat a couple that admits to cohabiting (for an appreciable period of time) just as they treat a couple that marries. In practice, however, administrators seldom go knocking on doors 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. In the few cases where officials do determine that a couple is cohabiting, many of the same issues arise anyway: what we describe as "marriage penalties" then become "marriage and admitted cohabitation penalties."

- **Example 3**: **An EITC bonus.** A nonworking mother with two children in Pennsylvania on TANF 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. Elected officials seldom engage the issue consistently or rigorously, primarily because they typically enact programs piecemeal, with little coordination or thought to how each new program affects 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. Because the programs were put into 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.

Why should we care about marriage in the first place? Many findings imply that "intrinsic" benefits accrue to the spouses and children in a marriage regardless of a couple's employment and education. In fairness, these findings are inconclusive as to whether the penalties had a large impact on marriage rates. Both quantitative and ethnographic research suggest 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. Still, a very large difficulty is determining how group effects 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 big role in this jerry-rigged system. Finally, whether couples figure out marriage penalties before they marry offers only limited evidence about the effect of the penalties on decisions to marry. People may react to incentives even when they do not calculate them, as when partners choose to cohabit or people remain single simply by observing that unmarried couples have a higher standard of living than those who marry—without necessarily understanding how rules in public programs create this result.

Finally, a warning is in order. Most current proposals to deal with health care for the non-elderly would impose very large marriage penalties on much of the population, expanding dramatically the penalties already demonstrated in this testimony.

Reducing Marriage Penalties

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 some initial steps to address it. 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, but combined benefit levels are higher for some recipients, which means their marriage penalties likely increased. Recent tax cuts also significantly reduced marriage penalties (or increased marriage subsidies) for most middle-income families that filed taxes. My research with Adam Carasso shows that the expansion of the child credit itself had a particularly strong effect on reducing marriage penalties for low- to middle-income families. For higher-income families, marriage bonuses were increased by the ways that the tax brackets were adjusted for joint returns. These various provisions are scheduled to expire, and the child credit erodes every year, as it is not indexed for inflation.

How Marriage Penalties and Subsidies Arise

Two conditions are necessary to cause marriage penalties and subsidies, and neither is sufficient by itself: variable tax rates and joint (or household, rather than single) filing. Understanding the conditions helps us understand what steps are necessary to reduce or eliminate these penalties.

DUAL CONDITIONS REQUIRED FOR MARRIAGE PENALTIES

- Tax rates or phase-out rates that vary based on income.
- Joint filing by married couples for benefits or taxes.

In many ways, high marriage penalties are the result of several decades of liberal-conservative compromise. 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. A household's loss of means-tested transfer benefits as earnings increase affects it in much the same way that 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. Benefits from some programs, like Medicaid and the State Children's Health Insurance Program (SCHIP), do not phase out gradually but instead fall swiftly (as off of a cliff) 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.

As evidenced by some examples above, the effective marginal tax rate—the rate created by steep benefit phase-out rates combined with Social Security and income tax rates—moves up and down a lot as income increases, 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.

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 such as Medicare or public education), 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 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 depends 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 have moved beyond the income cut-offs 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, like 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 costs of child care must be incurred). Households are much less likely to receive the programs in panel 2 than those in panel 1.[2]

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 about fully phased at the higher end of that range, while most other benefits are either still phasing in or have not yet phased out. Thereafter, benefits drop off steeply as earnings exceed $20,000.

Figure 2 compares the average effective marginal tax rates of various low- to middle-income single-parent families with two young children with the rate of more well-to-do families. The first three bars focus on the average effective marginal tax rates of single-parent families with income (including benefits) averaging between $10,000 and $40,000. The 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-waitlisted programs like food stamps, Medicaid, and SCHIP, the average effective marginal tax rate would be 58.8 percent. Enrolling the family in additional, waitlisted programs like housing assistance and child care ratchets up that rate to 88.6 percent. 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 one spouse has his or her earnings subject to “tax” 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 he earns discovers that upon marrying a woman with EITC and food stamp benefits, the introduction of his income into the household also reduces those benefits, as well as causes her to lose eligibility for Medicaid.

Figure 3 graphs one scenario showing (in dollars) the penalties and subsidies that would face a single earner and a single-parent head of household with two children and a combined income of $30,000 if they were to marry. (The penalties are much higher in the less common example when two single people, both with children, contemplate

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[2] 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.

marriage.) To take into account the various ways in which those earnings can be distributed within 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. 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 or subsidies are higher. In the figure, the curve with solid square markers shows the marriage penalties in the tax system alone; the curve with the diamond markers 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 all families in these income ranges face these penalties, 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.

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. 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 relatively low. SCHIP, meanwhile, replaces Medicaid's coverage of children at incomes between 185 and 235 percent of poverty (that is, for a family of four, between $36,000 and $45,000) 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).

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.

In my work with Adam Carasso, we offer four options for reform. The first two, in our opinion, deserve special consideration as newer, although untried, approaches. The latter two options have been applied in specific circumstances, but both would require major adjustments in benefit and tax structures if 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**. For high-income taxpayers, the maximum marginal tax rate has been reduced from about

70 percent to a range of 28 percent to 39 percent since 1986. Yet the maximum effective marginal tax rate for lower- to moderate-income households is often far higher—often 50, 60, 80, or even 100 percent when they earn more or marry. 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 to reduce marriage penalties.

- **Individual Wage Subsidies**. The EITC 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 many members of both political parties 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, as now happens.

- **Universal Programs**. A universal program or tax credit—one that goes to households with children without diminishment of benefits regardless of marital status or income—would clearly avoid 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

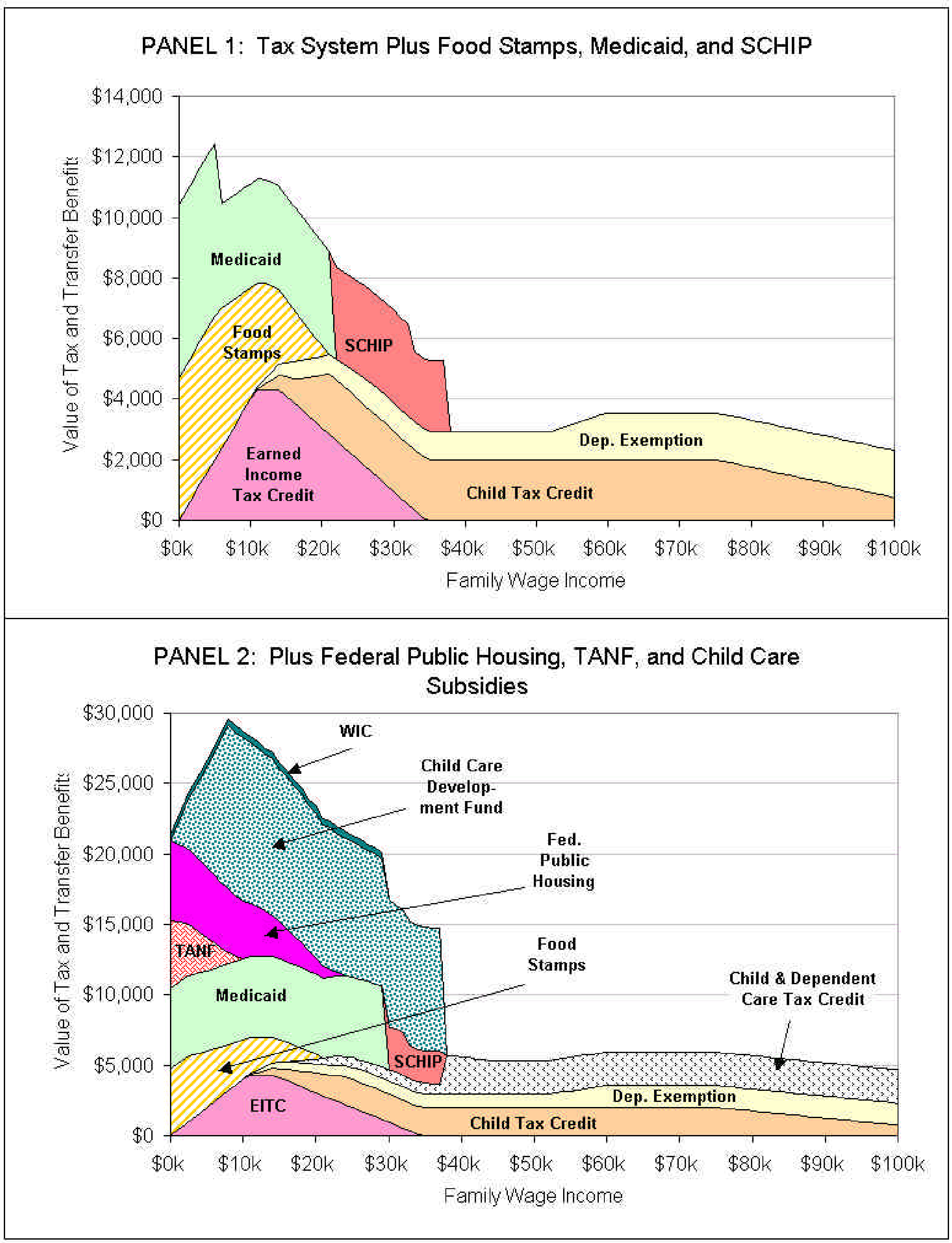
For several decades now, policymakers have created public tax and transfer programs with little if any attention to the sometimes-severe marriage penalties that they inadvertently impose. The expanded public subsidies thus put in place by lawmakers came at the expense of higher effective marginal tax 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. Cohabitating or 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 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.

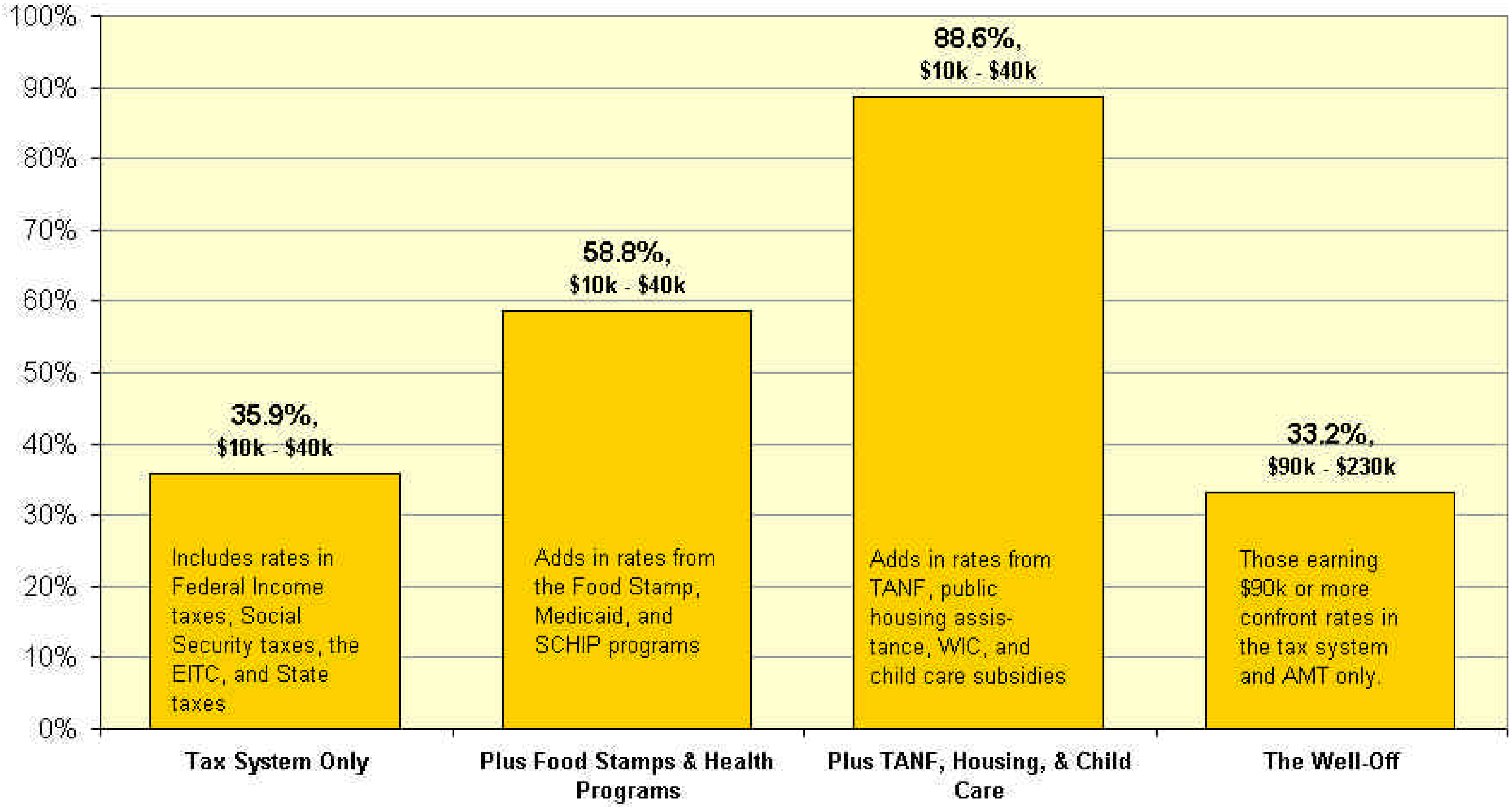
In recent years, couples in the United States have increasingly regarded marriage as an option, one among many ways of creating a household. This declining regard for marriage calls into question government's continued use of marriage vows as the primary mechanism by which to enforce household filing 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 penalty facing most low- and moderate-income individuals remains to be seen.

FIGURE 1: Select Tax and Transfer Benefits for a Head of Household with Two Children in Tax Year 2004



Source: Calculations by Adam Carasso and C. Eugene Steuerle, The Urban Institute, 2005. Notes: Child ages are assumed to be 2 and 5. 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. We assume $5,000 maximum annual child care costs. Note that in the second chart, the adults in a family previously on TANF remain eligible for Medicaid up to 185% of poverty (for up to 12 months after leaving TANF).

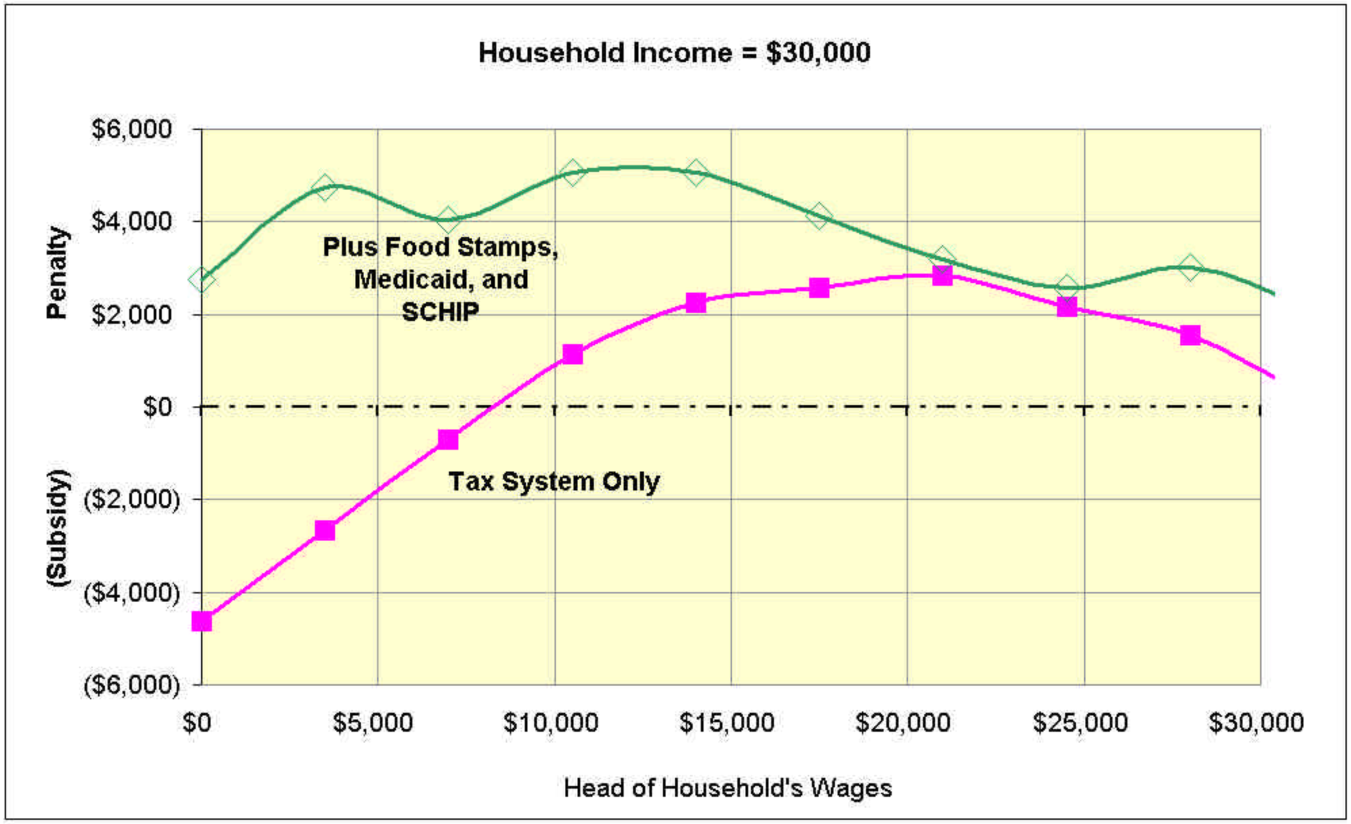
FIGURE 2. Comparison of Average Effective Marginal Tax Rates Among Families in Different Tax and Transfer Programs



Source: Calculations by Adam Carasso and C. Eugene Steuerle, The Urban Institute, 2005. Assumes family had two children and filed as head of household in tax year 2004.

FIGURE 3: Dollar Amount Of Marriage Penalties And Subsidies In Select Federal Tax And Transfer Programs For A Married Couple With Two Children In Tax Year 2004

(Assumes a single earner marries a head of household with two children who earns 0% to 100% of couple's income)



Note: The head of household has the two children prior to marriage. Her earnings range from 0% to 100% of household income in each example. The single earner earns the balance, and was a single filer without children, prior to marriage. Marriage penalties and subsidies include the effects of Social Security taxes (both the employer and employee portion) and state income taxes. Source: Calculations by Adam Carasso and C. Eugene Steuerle, The Urban Institute, 2005.