Possible Democratic Package

A fully paid for Democratic package of tax cuts would likely include a core set of tax cut proposals on marriage penalties, school construction, and extension of expiring tax provisions. Additional proposals could be included to fit available remaining revenues from payfors. A menu of potential tax initiatives is given on **page 2** of the handout.

The revenue raisers listed on **page 3** have been grouped into three categories, plus tobacco. The first grouping is "relatively noncontroversial" items, totaling **$3.5 billion** through 2003. These items have been included in bipartisan tax legislation this year. The second category, totaling **$15.3 billion** through 2003, lists "less noncontroversial" raisers. Given that a tax package needs to be financed, our subjective assessment is that these would be likely additional payfors. The third category (split into two groups) is labeled "controversial." These items would have significant opposition.

Illustrative Packages:

Illustrative package 1 (on **page 4**) includes only the core tax cut proposals: a phased in marriage penalty proposal (that eventually raises the standard deduction for joints filers to twice that of singles), a school construction initiative, and extensions of expiring provisions. The core tax cuts cost **$25.8 billion** through 2003. The first two categories of raisers total **$18.8 billion** through 2003. We have assumed that the reinstatement of the two Superfund environmental taxes are used to make up the difference in the cost of cuts and payfors.

Illustrative package 2 (on **page 5**) adds child care, pension and low-income housing initiatives to the core set of tax cuts. It pays for the additional tax cuts with a 20 cent per pack increase in the cigarette excise tax through 2002 and a 30 cents per pack increase thereafter.

Discussion

Financing even the base package will involve tough choices. Some will object strongly to using the Superfund taxes to pay for tax cuts rather than environmental remediation. A likely alternative, replacing the sales source rule with activity-based rules (which has been in the President's budget the last two years), will be opposed by some who worry that this change could harm international competitiveness.

The financing constraint <u>may</u> be somewhat easier under Joint Committee scoring. Because of baseline differences, the JCT scores the liquidating REIT proposal as raising $4.4 billion more than Treasury through 2003 (and $7.6 billion more through 2008). Cutting the other way, the JCT has not scored the President's budget proposal to modify reserve rules for annuity contracts (CARV-M), which complicates inclusion in a Congressional package. The CARV-M proposal, which affects life insurance companies, would raise $4.6 billion through 2003 and $8.5 billion through 2008.

Budget -
Taxes

Menu for Potential Democratic Tax Package
Tax Cuts

	1998-2003	1998-2008
*Core Initiatives (** indicates very rough estimate)*		
Marriage Penalty Relief /1		
Increase the standard deduction for joint filers to double that for singles	-25,846	-55,634
Introduce a 10% second-earner deduction (up to $30k of earnings)**	-60,000	-120,000
Reduce EITC marriage penalties**	-10,000	-20,000
Gramm, Senate-passed marriage penalty proposal (already phased in) /2	-14,400	-38,600
School Construction		
School construction bonds, increase Qualified Zone Academy Bonds	-5,007	-11,552
Extend Expiring Provisions		
R&E tax credit (6/30/99) /3	-2,209	-2,218
Work Opportunity Tax Credit (4/31/00)	-783	-806
Welfare-to-Work tax credit (4/31/00)	-169	-181
Contributions of stock to private foundations (6/30/99)	-67	-67
*Additional Items if Payfors are Available (** indicates very rough estimate)*		
Make Child Care More Affordable		
Increase child and dependent care tax credit	-5,113	-11,785
Employer-provided child-care tax credit	-478	-1,268
Kennelly stay-at-home parent credit**	-3,500	-7,000
Extend Availability of Pensions /4		
3-Year subsidy plus voluntary excludable IRA -- small firms and all qualified plans	-508	-945
Simplified pension plan for small business	-304	-555
Other Pension Initiatives	-145	-395
Education Initiatives		
Extend employer-provided educational assistance and include graduate education	-1,049	-1,049
Increase Low-Income Housing Tax Credit and Urban Initiatives		
Increase per capita cap to $1.75	-1,559	-6,723
Accelerate startup of two new EZ/ECs	-63	-150
Make permanent the expensing of brownfields remediation costs	-534	-1,338
Increase Energy Efficiency and Improve the Environment		
President's climate change technology tax initiative	-3,625	-9,006
Speedup of Self-Employed Health Insurance Deduction		
Acceleration of self-employed health insurance deduction	-5,500	-8,100
Assist Taxpayers with Long-Term Care Needs		
Extend child credit to taxpayers with chronic illness and ill spouse or dependent	-4,700	-11,400
Same provision as above, but $1,000 rather than $500 credit	-9,000	-21,600
$1,000 credit for home or community care	-4,700	-11,800
Capped, 75 percent tax credit for qualified long-term care expenses	-4,600	-10,500
Simplify and Enhance the Progressivity of Capital Gains Taxation		
40 percent exclusion for long-term capital gains	-8,000	-9,000

/1 Each marriage penalty proposal can be "dialed down" to meet a smaller revenue target
/2 JCT scores this as costing $16.1b through 2003 and roughly $46b through 2008
/3 Numbers do not match the Budget because this entry includes costs in 1998 (this is $365 million)
/4 Numbers do not match the Budget because this entry includes costs in 1998 ($42 million)

Revenue Offsets
[$ in millions]

		1998-2003	1998-2008
Relatively Noncontroversial			
Modify Foreign Tax Credit carryover rules*	/1	1,925	3,391
Clarify and expand math-error procedures	/1	672	1,400
Liquidating REITs	/2	500	1,000
Constructive ownership (Kennelly)*		150	300
Clarify the meaning of "subject to" liabilities under section 357(c)	/1	120	439
Restrict special net operating loss carryback rules for specified liability losses	/1	104	255
	Subtotal	3,471	6,785
Less Noncontroversial			
Modify reserve rules for annuity contracts (CARV-M)	/3	4,641	8,532
Modify corporate-owned life insurance (COLI) rules		2,455	5,253
Repeal lower-cost-or-market inventory accounting method		1,663	1,947
Reform treatment of FOGI and dual capacity taxpayers*		1,500	3,900
Reinstate Oil Spill excise tax		1,255	2,576
Eliminate non-business valuation discounts		1,008	2,468
Repeal percentage depletion for nonfuel minerals on Federal and formerly Federal lands		478	1,003
Increase proration percentage for P&C insurance companies		380	1,331
Amend 80/20 company rules		249	526
Modify treatment of foreign built-in losses		243	547
Defer deduction for interest and OID on convertible debt		166	549
Eliminate dividends-received deduction for certain preferred stock		157	611
Tighten substantial understatement penalty for large corporations		147	241
Repeal tax-free conversions of large C corporations into S corporations		144	602
Apply 7.7% rate to credit life insurance premiums		125	140
Repeal 14-day rule for vacation homes*		123	274
Extend pro-rata disallowance of tax-exempt interest expense to all financial intermediaries		109	293
Reduce "investment in the contract" for mortality and expense charges		100	1,360
Eliminate "Crummey" rule		87	213
Impose excise tax on purchase of structured settlements		82	212
Increase penalties for failure to file correct information returns		65	131
Modify depreciation method for tax-exempt use property		55	261
Modify foreign office material participation exception		50	111
Stop abuse of CFC exception to ownership requirements of IRS code section 887		30	59
Eliminate gift tax exemption for personal residence trusts		25	525
Include QTIP trust assets in surviving spouse's estate		8	21
Modify Federal Unemployment Act provisions		0	1,511
	Subtotal	15,345	35,197
Controversial Ideas			
Replace sales source rule with activity-based rules (subset of Title Passage, below)		6,571	16,273
Superfund AMT tax*		3,800	5,000
Superfund excise tax*		3,600	5,000
Royalties in passive basket of foreign tax credit; 100% R&E allocation +		3,000	6,000
Reduce dividends-received deduction to 50%		1,662	3,835
Variable annuities		929	5,089
Repeal components of cost inventory method		895	2,071
Deny interest deduction on certain debt instruments		649	2,691
	Subtotal	21,106	45,959
Controversial CBO & Congressional Ideas			
Excise tax on nonretirement fringe benefits (McDermott) +		**28,900**	**57,800**
Title Passage, tax repatriated FSC income+		**24,100**	**59,683**
Repeal expensing of exploration and development costs+		**4,400**	**9,100**
Repeal percentage depletion +		**2,400**	**5,100**
Minimum tax on foreign-owned business+		**1,800**	**3,600**
Runaway plants (Dorgan) +		**1,500**	**3,000**
	Subtotal	**63,100**	**138,283**
Tobacco			
Accelerate cigarette excise tax increase +		3,000	3,000
10-cent tobacco excise tax (could be scaled up) +		7,500	15,000
Disallow deduction for tobacco advertising +		4,000	8,200
	Subtotal	14,500	26,200

* = JCT scoring
\+ = rough guess
1. Used in the Senate's version of IRS Restructuring
2. JCT estimates at 4.9 b over five years, 8.6 b over 10 years
3. JCT has not estimated this provision

Tax Package I

Tax Cuts

(** *indicates very rough estimate)*

		1998-2003	1998-2008
Marriage Penalty Relief			
Raise joint standard deduction to twice singles (flat phase-in, jump in 2009)**		-18000	-37000
School Construction			
School construction bonds, increase Qualified Zone Academy Bonds		-5,007	-11,552
Extend Expiring Provisions			
R&E tax credit (6/30/99)		-2,209	-2,218
Work Opportunity Tax Credit (4/31/00)		-783	-806
Welfare-to-Work tax credit (4/31/00)		-169	-181
Contributions of stock to private foundations (6/30/99)		-67	-67
Subtotal		-3,228	-3,272
Total		-26,235	-51,824

Raisers

		1998-2003	1998-2008
Relatively noncontroversial			
Modify Foreign Tax Credit carryover rules	/1	1,925	3,391
Liquidating REITs**	/2	500	1,000
Clarify and expand math-error procedures	/1	672	1,400
Constructive ownership (Kennelly)**		150	300
Clarify the meaning of "subject to" liabilities under section 357(c)	/1	120	439
Restrict special net operating loss carryback rules for specified liability losses	/1	104	255
Subtotal		3,471	6,785
Less noncontroversial			
Modify reserve rules for annuity contracts (CARV-M)	/3	4,641	8,532
Modify corporate-owned life insurance (COLI) rules		2,455	5,253
Repeal lower-cost-or-market inventory accounting method		1,663	1,947
Reform treatment of FOGI and dual capacity taxpayers**		1,500	3,900
Reinstate Oil Spill excise tax		1,255	2,576
Eliminate non-business valuation discounts		1,008	2,468
Repeal percentage depletion for nonfuel minerals on Federal and formerly Federal lands		478	1,003
Increase proration percentage for P&C insurance companies		380	1,331
Amend 80/20 company rules		249	526
Modify treatment of foreign built-in losses		243	547
Defer deduction for interest and OID on convertible debt		166	549
Eliminate dividends-received deduction for certain preferred stock		157	611
Tighten substantial understatement penalty for large corporations		147	241
Repeal tax-free conversions of large C corporations into S corporations		144	602
Apply 7.7% rate to credit life insurance premiums		125	140
Repeal 14-day rule for vacation homes**		123	274
Extend pro-rata disallowance of tax-exempt interest expense to all financial intermediaries		109	293
Reduce "investment in the contract" for mortality and expense charges		100	1,360
Eliminate "Crummey" rule		87	213
Impose excise tax on purchase of structured settlements		82	212
Increase penalties for failure to file correct information returns		65	131
Modify depreciation method for tax-exempt use property		55	261
Modify foreign office material participation exception		50	111
Stop abuse of CFC exception to ownership requirements of IRS code section 887		30	59
Eliminate gift tax exemption for personal residence trusts		25	525
Include QTIP trust assets in surviving spouse's estate		8	21
Modify Federal Unemployment Act provisions		0	1,511
Subtotal		15,345	35,197
Controversial			
Superfund AMT tax		3,800	5,000
Superfund excise tax		3,600	5,000
Subtotal		7,400	10,000
Total		26,216	51,982
Net Budget Effect		-19	158

1. Used in the Senate's version of IRS Restructuring
2. JCT estimates at 4.9 b over five years, 8.6 b over 10 years
3. JCT has not estimated this provision

Tax Package II

Tax Cuts

*(** indicates very rough estimate)*

		1998-2003	1998-2008
Marriage Penalty Relief			
Raise joint standard deduction to twice singles (phased-in) **		-24,000	-51,000
School Construction			
School construction bonds, increase Qualified Zone Academy Bonds		-5,007	-11,552
Extend Expiring Provisions			
R&E tax credit (6/30/99)		-2,209	-2,218
Work Opportunity Tax Credit (4/31/00)		-783	-806
Welfare-to-Work tax credit (4/31/00)		-169	-181
Contributions of stock to private foundations (6/30/99)		-67	-67
Subtotal		-3,228	-3,272
Make Child Care More Affordable			
Increase child and dependent care tax credit		-5,113	-11,785
Employer-provided child-care tax credit		-478	-1,268
Subtotal		-5,591	-13,053
Extend Availability of Pensions			
3-Year subsidy plus voluntary excludable IRA -- small firms and all qualified plans		-508	-945
Simplified pension plan for small business		-304	-555
Other Pension Initiatives		-145	-395
Subtotal		-957	-1,895
Increase Low-Income Housing Tax Credit and Urban Initiatives			
Increase per capita cap to $1.75		-1,559	-6,723
Accelerate startup of two new EZ/ECs		-63	-150
Make permanent the expensing of brownfields remediation costs		-534	-1,338
Subtotal		-2,156	-8,211
Total		-40,939	-88,983

Raisers

		1998-2003	1998-2008
Relatively noncontroversial			
Modify Foreign Tax Credit carryover rules	/1	1,925	3,391
Liquidating REITs**	/2	500	1,000
Clarify and expand math-error procedures	/1	672	1,400
Constructive ownership (Kennelly)**		150	300
Clarify the meaning of "subject to" liabilities under section 357(c)	/1	120	439
Restrict special net operating loss carryback rules for specified liability losses	/1	104	255
Subtotal		3,471	6,785
Less noncontroversial			
Modify reserve rules for annuity contracts (CARV-M)	/3	4,641	8,532
Modify corporate-owned life insurance (COLI) rules		2,455	5,253
Repeal lower-cost-or-market inventory accounting method		1,663	1,947
Reform treatment of FOGI and dual capacity taxpayers**		1,500	3,900
Reinstate Oil Spill excise tax		1,255	2,576
Eliminate non-business valuation discounts		1,008	2,468
Additional offsets under $500 m through 2003; identical to package I		2,823	10,521
Subtotal		15,345	35,197
Controversial			
Superfund AMT tax		3,800	5,000
Superfund excise tax		3,600	5,000
Subtotal		7,400	10,000
Tobacco			
20-cent per pack excise tax increase through 2002, 30 cents thereafter		15,000	37,500
Total		41,216	89,482
Net Budget Effect		277	499

1. Used in the Senate's version of IRS Restructuring
2. JCT estimates at 4.9 b over five years, 8.6 b over 10 years
3. JCT has not estimated this provision

Elements of a Democratic Package

A fully paid for Democratic package of tax cuts would likely include a core set of proposals on marriage penalties, school construction, and expiring tax provisions. Additional proposals would be included, subject to available payfors.

Core Tax Cut Proposals (addition material on the core cuts is given on page 5)

- **Marriage Penalty Relief.** There are several options. The first three could be phased in aggressively to minimize their cost through 2003 (the fourth, the Gramm proposal, is already aggressively phased in).

  - **Increase Standard Deduction for Joint Filers.** Increasing the standard deduction for joint filers to double the current level for single filers would cost **roughly $26 billion through 2003.**

    Fifty-four percent of the revenue loss would actually reduce marriage penalties. Couples with income (AGI) under $30,000 would receive 24 percent of the tax cut; couples with AGI over $100,000 would receive only 5 percent of the tax cut. The tax cut in 1999 for a one- or two-earner couple, each with $25,000 in earnings and no other income, and who currently use the standard deduction would be $217.50. This change would also simplify the tax system by reducing the number of taxpayers itemizing deductions by several million.

  - **Two-Earner Deduction.** The second earner deduction that existed between 1982 and 1986 could be reinstated. (This has been introduced by Herger, H.R. 2593.) The deduction was for 10 percent of the first $30,000 of the earnings of the spouse with lower earnings. This would cost **very roughly $60 billion through 2003.**

    Nearly 80 percent of the revenue loss would actually reduce marriage penalties. Couples with income (AGI) under $30,000 would receive 12 percent of the tax cut; couples with AGI over $100,000 would receive 32 percent of the tax cut. The tax cut in 1999 for a two-earner couple, each with $25,000 in earnings and no other income, would be $375.

  - **Reduction in Marriage Penalties in the EITC.** H.R. 3995 (Neal, McDermott, and Kennelly) would reduce marriage penalties in the EITC by raising the endpoint of the "plateau" for married couples filing a joint return by $3,510 (in 1999), which would also raise the income level at which the EITC is fully phased out by the same amount. This would cost **very roughly $10 billion through 2003.**

    Less than 40 percent of the revenue loss would actually reduce marriage penalties. Couples with income (AGI) under $30,000 would receive 92 percent of the tax cut; couples with AGI over $100,000 would receive none of the tax cut. The tax cut in 1999 for a one- or two-earner couple with $24,000 in total earnings, no other income, and one child would be $561.

- **Senator Gramm's Amendment to the Tobacco Bill**. The Gramm amendment would give a new deduction to married couples filing a joint return who have combined incomes below $50,000. The deduction would be equal to the difference between the sum of the standard deductions for a single filer and a head of household filer, and the standard deduction for a joint filer (this difference is $3,450 in 1999). The deduction would be available to all such couples, whether or not they itemized deductions (i.e., the deduction would be "above-the-line"). The deduction would also reduce income for purposes of the phaseout of the Earned Income Tax Credit (EITC), so couples with incomes in the phaseout range of the EITC would get a larger credit. The $50,000 income limit would be indexed for inflation after 2007. The deduction would be phased in over 10 years. This would cost **$14.4 billion through 2003** and approximately **$9 billion per year** when fully phased in.

  The new deduction would be phased in, 25 percent in 1999; 30 percent in 2000, 2001, and 2002; 40 percent in 2003, 2004 and 2005; 50 percent in 2006; 60 percent in 2007; and 100 percent in 2008 and subsequent years.

  Only 35 percent of the revenue loss would actually reduce marriage penalties. Couples with income (AGI) under $30,000 would receive 62 percent of the tax cut; couples with AGI over $100,000 would receive none of the tax cut. The tax cut when fully phased in at 1999 levels for a one- or a two-earner couple with $50,000 in total earnings and no other income, would be $518.

- **School Construction**. The Budget proposal would allow state and local governments to issue up to $9.7 billion of "qualified school construction bonds" in each of 1999 and 2000. It would also increase the limit for "qualified zone academy bonds" by $1 billion in 1999, authorize $1.4 billion of such bonds in 2000, and allow bond proceeds to be used for school construction. These provisions would cost **$5.0 billion through 2003.**

- **Extenders**. The research and experimentation tax credit, the work opportunity tax credit (WOTC), and the deduction for contributions of appreciated stock to private foundations all expired June 30. The welfare-to-work tax credit expires April 30, 1999. Extending these provisions as proposed by the President would cost **$3.2 billion through 2003.**

The Menu of Payfors

The revenue raisers (see the third page of the handout) have been grouped into three categories, plus tobacco. The first grouping is "relatively noncontroversial" items. These items have been included in bipartisan tax legislation this year. The second category are "less noncontroversial" raisers, but given that a tax package needs to be financed, our subjective assessment is that these would be likely additional payfors. The third category (split into two groups) is labeled "controversial." These items have significant opposition.

Possible Additional Tax Cut Proposals

Some of the following proposals could be included in a Democratic package, within the constraint of revenues from payfors remaining after the core proposals.

- **Child Care.** There are at least two options:

  - **Budget Proposal.** The Budget proposal would increase the maximum rate of the child and dependent care tax credit from 30 percent to 50 percent and extend eligibility for the maximum credit from $10,000 to $30,000. The proposal would also provide a new credit to employers of up to $150,000 for 25 percent of expenses incurred to build or acquire a child care facility for employee use or for providing child care services for employees. These proposals would cost **$5.6 billion through 2003.**

  - **Stay-at-home parent provision.** H.R. 4030 (Kennelly) includes the Budget proposal, and a provision that would make taxpayers with children under the age of four eligible for an expanded child credit that would be roughly equal to the average proposed increase in the child and dependent care tax credit for taxpayers under the age of four. A taxpayer could not claim both the expanded child credit and the child and dependent care tax credit. The stay-at-home piece of the Kennelly child care package would cost roughly **$3.5 billion through 2003.**

- **Pensions.** The Budget proposed promoting IRA contributions through payroll deduction, providing a tax credit to small businesses for 50 percent of the costs (up to $2,000 in the first year and $1,000 in the second year) for expenses of administering or providing employee education for a new qualified plan, the establishment of a new small business plan, and enhancing pension portability, disclosure, and simplification. These proposals would cost **$1.0 billion through 2003.**

- **Education.** Extending employer-provided educational assistance (Section 127) by one year (to 6/1/2001) and reinstating the exclusion for graduate education (effective 6/30/98 through 6/1/2001) would cost **$1.0 billion through 2003.**

- **Low Income Housing Tax Credit and Urban Initiatives.** The Budget proposal would increase the per capita limitation from $1.25 to $1.75 at a cost of **$1.6 billion through 2003.** Making the brownfields expensing provision permanent would cost **$0.5 billion through 2003.** Accelerating the startup date for the two new empowerment zones created by TRA97 by one year (to 1/1/99) would cost **0.1 billion through 2003.**

- **Climate Change.** The tax proposals in the Budget are intended to reduce energy consumption and greenhouse gas emissions by encouraging the deployment of technologies that are highly energy efficient and that use renewable energy sources. The nine initiatives in total would cost **$3.6 billion through 2003.**

- **Speedup of 100 Percent Deduction for Self-Employed Health Insurance.** Currently, the percentage of health insurance expenses that may be deducted by a self-employed individual is 45 percent. This percentage is scheduled to increase to 50 percent in 2000 and 2001, 60 percent in 2002, 80 percent in 2003 through 2005, 90 percent in 2006, and 100 percent in 2007 and thereafter. Accelerating this schedule by making the deduction 100 percent beginning in 1999 would cost **$5.5 billion through 2003.**

- **Long-Term Care.** The following are three options that might be considered:

  - **Option 1.** Providing a tax credit of $500 for taxpayers who are chronically ill, or who care for a chronically ill spouse or dependent would cost approximately **$5 billion through 2003.** Increasing the credit to $1,000 would cost approximately **$9 billion through 2003.**

  - **Option 2.** Creating a new, nonrefundable tax credit of $1,000 for taxpayers who pay for or provide home-based or community long-term care services for themselves or a chronically ill spouse or dependent would cost approximately **$4.7 billion through 2003.**

  - **Option 3.** Creating a new, nonrefundable tax credit for 75 percent of the first $2,000 of qualified long-term expenses for taxpayers with a chronic illness or chronically ill spouse or dependent would cost approximately **$4.6 billion through 2003.**

- **Capital Gains.** If it were thought desirable to have a capital gains counter to the Republican proposal, an alternative could be fashioned that would provide greater simplicity and equity.

  - One possibility would be to substitute a 40 percent exclusion for the current system of special rates. This would hold harmless or cut taxes for people in the 15 percent and 28 percent brackets (in particular, it would give taxpayers in the 15 percent bracket a rate of 9 percent on gains vs. 10 percent under current law, and taxpayers in the 28 percent bracket a rate of 16.8 percent on gains). Taxpayers in the 39.6 percent bracket would have a rate of 23.76 percent on gains (versus 20 percent under current law). Current rates are scheduled to fall to 8 percent and 18 percent for property held more than five years. The cost of a 40 percent exclusion would be roughly **$8 billion through 2003.**

Detailed Descriptions of Core Proposals

Marriage Penalty Relief

- **Increase Standard Deduction for Joint Filers**. The standard deduction for joint filers ($7,250 in 1999) would be increased to double the standard deduction for single filers ($4,350 in 1999). This would give joint filers a standard deduction of $8,700 in 1999, which is $1,450 more than under current law. For joint filers in the 15 percent bracket who use the standard deduction, this increase would reduce their taxes by $217.50. Joint filers in the 28 percent bracket who use the standard deduction would have taxes reduced by $406.

  This proposal would reduce the number of returns with itemized deductions in 1999 by 3.1 million, from 39.2 million to 36.1 million.

- **Two-Earner Deduction** (H.R. 2593; Herger). This proposal would reinstate the second earner deduction that existed between 1982 and 1986. The deduction is for 10 percent of the first $30,000 of the earnings of the spouse with lower earnings.

  This proposal violates the principal in current law that couples with identical total incomes pay identical total taxes, since only couples with two earners would receive the two-earner deduction.

- **Reduction in Marriage Penalties in the EITC** (H.R. 3995; Neal, McDermott, and Kennelly). The proposal would raise the endpoint of the "plateau" of the Earned Income Tax Credit (EITC) for married couples filing a joint return by $3,510 (from $12,510 to $16,020) in 1999. (The "plateau" is the income range in which the EITC is at a maximum.) Raising the endpoint of the "plateau" would also raise the income at which the EITC is fully phased out by the same amount ($3,510 in 1999).

  The proposal would increase "singles penalties" by **over $3 billion per year** (at 1999 income levels), because heads of households with incomes in the proposed EITC "plateau" and phaseout ranges would owe even more tax than a one-earner couple with the same income, deductions, and personal exemptions than under current law.

- **Senator Gramm's Amendment to the Tobacco Bill**. This amendment, which includes a provision to accelerate the full deduction of health insurance premiums by the self-employed, was adopted by the Senate on June 10. The marriage penalty provision would give an additional deduction to married couples filing a joint return who have combined incomes below $50,000. The deduction would be equal to the difference between the sum of the standard deductions for a single filer and a head of household filer, and the standard deduction for a joint filer (this difference is $3,450 in 1999). It would be available to all such couples, whether or not they itemized deductions (i.e., the deduction would be "above-the-line"). The deduction would also reduce income for purposes of the phaseout of the

Earned Income Tax Credit (EITC), so couples with incomes in the phaseout range of the EITC would get a larger credit. The $50,000 income limit would be indexed for inflation after 2007. The deduction would be phased in, 25 percent in 1999; 30 percent in 2000, 2001, and 2002; 40 percent in 2003, 2004 and 2005; 50 percent in 2006; 60 percent in 2007; and 100 percent in 2008 and subsequent years.

In 1999, the additional deduction would be 25% x $3,450 = $862.50, which would be worth $129 for couples with sufficient taxable income (since couples in this income range are in the 15 percent bracket). When fully phased in, the additional deduction (at the 1999 level of $3,450) would be worth $517.50. With the change in the EITC, the fully-phased-in tax reduction for a one- or two-earner couple with $24,000 in total earnings, no other income, and one child would be $1,069.

The proposal would also increase "singles penalties" by **$17 billion per year** (at 1999 income levels), because unmarried taxpayers with incomes below $50,000 would owe even more tax than a one-earner couple with the same income, deductions, and personal exemptions than under current law.

The provision would create a "cliff," whereby couples with $50,000 of income would get a tax cut of $517.50 (when fully phased in) while a couple with $1 more of income would get nothing. This creates large disincentives to earn income or large incentives to misreport income for taxpayers with incomes above the cliff.

School Construction

The Taxpayer Relief Act of 1997 enacted a provision that allows certain public schools to issue "qualified zone academy bonds," the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds can be used for a number of purposes, including teacher training, purchases of equipment, curricular development, and rehabilitation and repair of the school facilities. The Budget proposes to institute a new program of Federal tax assistance for public school construction. Under the proposal, State and local governments would be able to issue up to $9.7 billion of "qualified school construction bonds" in each of 1999 and 2000. Holders of these bonds would receive annual federal income tax credits, set according to market interest rates by the Treasury Department, in lieu of interest. At least 95 percent of the bond proceeds of a qualified school construction bond must be used to finance public school construction or rehabilitation. The Budget also proposes to expand the amount of qualified zone academy bonds that can be issued in 1999 from $400 million to $1.4 billion and to authorize an additional $1.4 billion of qualified zone academy bonds in 2000, and to allow the proceeds of these bonds to be used for school construction.

Extension of Expiring Provisions

- **Extend the Work Opportunity Tax Credit.** The Work Opportunity Tax Credit provides an incentive for employers to hire individuals from certain targeted groups. The credit equals a percentage of qualified wages paid during the first year of the individual's employment with the employer. The credit percentage is 25 percent for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The credit expires with respect to employees who begin work after June 30, 1998. The Budget proposes to extend the Work Opportunity Tax Credit so that the credit would be effective for individuals who begin work before May 1, 2000.

- **Extend for One Year the Welfare-to-Work Tax Credit.** The Welfare-to-Work Tax Credit enables employers to claim a tax credit on the first $20,000 of eligible wages paid to certain long-term family assistance recipients. The credit is 35 percent of the first $10,000 of eligible wages in the first year of employment and 50 percent of the first $10,000 of eligible wages in the second year of employment. The credit is effective for individuals who begin work before May 1, 1999. The Budget proposes to extend the Welfare-to-Work Tax Credit for one year, so that the credit would be effective for individuals who begin work before May 1, 2000.

- **Extend for One Year the R&E Tax Credit.** The Budget proposes to extend the tax credit provided for certain research and experimentation expenditures, which is scheduled to expire after June 30, 1998, for one year through June 30, 1999.

- **Contributions of Appreciated Stock to Foundations.** The special rule that allows a taxpayer to deduct the full fair market value of qualified stock donated to a private foundation expires with respect to contributions made after June 30, 1998. The Budget proposes to extend the provision to apply to contributions made during the period July 1, 1998 through June 30, 1999.

FIG -
Budget -
Taxes

CENTER ON BUDGET AND POLICY PRIORITIES

January 27, 1998

TAXPAYERS WILL HAVE NEW TAX CUTS EVEN IF NO ADDITIONAL REDUCTIONS ARE ENACTED

by Iris J. Lav

The Taxpayer Relief Act of 1997 that was enacted last summer includes a number of provisions for which the effective date of the tax reduction is delayed to future years. This is a major reason why the cost of the new tax law increases over time from $9.5 billion in fiscal year 1998 to $35 billion in 2003 and $41.6 billion in fiscal year 2007.

One consequence of these delayed effective dates is that taxpayers will experience *new* tax cuts in most years over the next decade even if no additional tax reductions are enacted in this or subsequent years. This means any tax reductions Congress considers in the 1998 session would come on top of the substantial tax cuts already scheduled to take place between now and 2007.

There are, for example, a number of tax cuts included in the 1997 legislation that first take effect in 1999. Tax cuts beginning in tax year 1999 include the following:

- Taxpayers with children under age 17 will receive an additional tax credit of $100 per child in 1999, because the maximum child tax credit increases from $400 per child in 1998 to $500 per child in 1999.[1]

- Students or parents paying interest on student loans will be able to deduct $1,500 of such interest in 1999, as compared to a maximum deduction of $1,000 in 1998.

- Some taxpayers who work from a home office will enjoy liberalized rules for deducting expenses starting in 1999.

- For heirs of a person dying in 1999, a larger amount of the estate will be exempt from taxation than would have been the case in 1998; the estate tax exemption increases from $625,000 in 1998 to $650,000 in 1999.

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[1] Some of the tax provisions listed here are phased out for families and individuals with incomes above specified levels.

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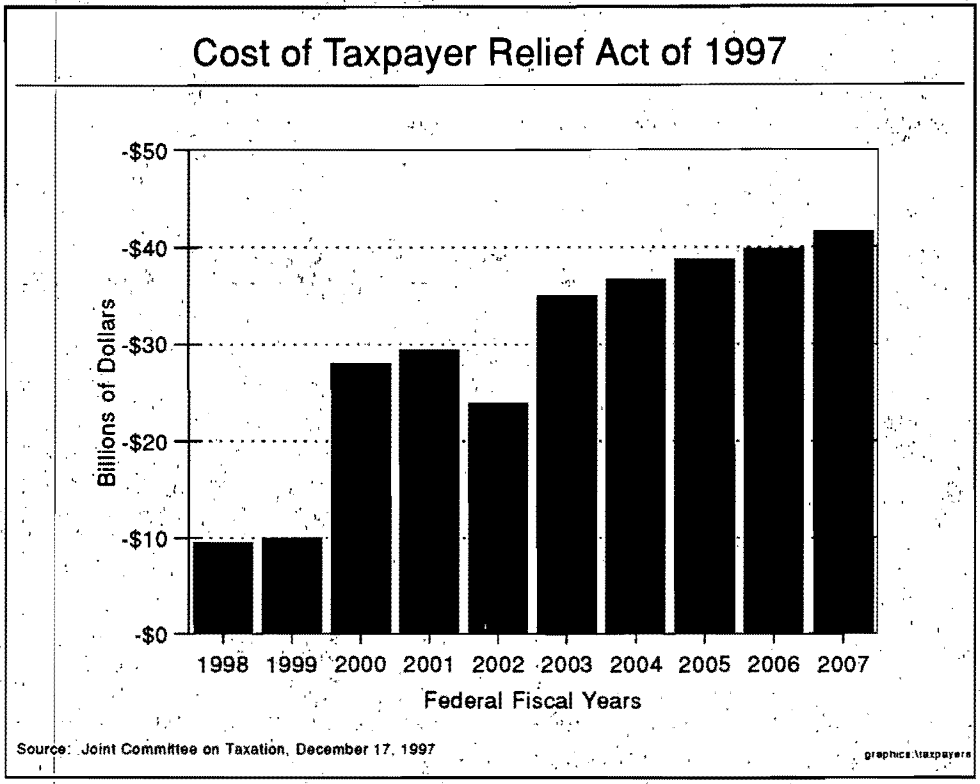

- Some profitable corporations that might have been subject to the Alternative Minimum Tax because they used a combination of deductions and credits to reduce their tax liability below an acceptable level will be able to avoid paying some or all of these taxes in 1999. Starting in 1999, corporations will be allowed to use more generous depreciation allowances in calculating their AMT liability.

These additional tax cuts already enacted into law for 1999 are far from trivial in cost. While the Taxpayer Relief Act of 1997 will cost $9.9 billion in fiscal year 1999, its cost rises nearly three-fold to $27.9 billion in fiscal year 2000, when the effect of the additional tax cuts for tax year 1999 will first be fully felt. (Tax cuts that are effective for tax year 1999 will, in substantial measure, be reflected in smaller amounts of taxes owed or larger refunds provided in April, 2000, when tax returns for 1999 are due.)

Taxpayers will continue to reap new, additional tax cuts in years beyond 1999. The following are examples of new tax cuts that will take effect in future years.

- Taxpayers at increasingly higher income levels will become eligible to make deductible contributions to Individual Retirement Accounts. The income limits for tax-deductible IRA contributions by married taxpayers increase gradually from $60,000 in 1998 to $100,000 in 2007 and thereafter.

For single taxpayers, the income limits for these tax-favored savings accounts increase from $40,000 in 1998 to $60,000 in 2005 and thereafter.

- For students and families of students, the maximum amount of student loan interest that may be deducted from income each year will continue to rise, increasing from $1,500 in 1999 to $2,000 in 2000 and reaching $2,500 for 2001 and subsequent years.

- Beginning in 2003, students or parents may take an annual "lifetime learning credit" of 20 percent of the first $10,000 of annual tuition payments. Prior to 2003, only the first $5,000 in tuition will be eligible for a credit. The maximum annual tuition credit a taxpayer may take will consequently rise in 2003 from $1,000 to $2,000.

- Self-employed individuals will be able to deduct from their incomes an increasing proportion of their health insurance expenses. They will be allowed to deduct 50 percent of expenses in 2000 and 2001, 60 percent in 2002, 80 percent in 2003 through 2005, 90 percent in 2006, and the entirety of their health insurance expenses in 2007.

- For investors, the maximum capital gains tax rate on assets held for more than five years will drop from 20 percent to 18 percent beginning in 2001.

- The amount of an estate exempt from taxation is set to rise each year, reaching $1 million in 2006 and thereafter.

The additional tax cuts that become newly available over the course of the next decade substantially increase the cost of the tax legislation enacted in 1997. The $41.6 billion cost of the tax package in 2007 is far greater than the $9.9 billion the tax breaks will cost in 1999.

These tax cuts also contribute to a decline in tax revenues as a percentage of the economy over the next decade. According to the Congressional Budget Office, tax revenue will drop from 19.9 percent of GDP in fiscal year 1998 to 19.3 percent of GDP in fiscal year 2003.

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February 4, 1998

FEDERAL GOVERNMENT WOULD CONTINUE TO CONSUME LESS OF ECONOMY UNDER ADMINISTRATION'S BUDGET

Tax Burdens Would Edge Down Slightly

by Robert Greenstein

The new Clinton Administration budget contains a substantial number of program initiatives. The inclusion of these initiatives in the budget has led to several questions, including:

- Does the budget represent a return to "big government"?
- Does the budget include a substantial tax increase?
- Does the budget breach federal discipline?

Examination of the budget shows the answer to all three questions to be "no." Under the budget, the government would continue to contract as a share of the economy between now and 2003, while taxes would be slightly lower than they are today as a percentage of income in four of the next five years. In addition, all of the projected surpluses in the unified budget would be preserved rather than spent.

Budget Contains Both Program Expansions and Program Reductions

Much attention is being focused on the initiatives in the budget, which would expand programs and tax credits. The budget also contains some significant program reductions although the Administration has not highlighted them. Some Administration critics have said that the budget contains $150 billion in added spending and expanded tax credits, but this figure counts only program increases and new or expanded tax credits without subtracting program decreases and provisions that pay for the tax credits by closing inefficient tax breaks. (See box on page 3.)

The budget includes more than $30 billion over five years in reductions in entitlement programs, which are used to help pay for expansions in other programs, including discretionary programs. For example, the budget would save $17 billion over five years by limiting the payment of cash benefits under the veterans disability compensation program to veterans claiming disability on the basis of a smoking-related condition or illness that became manifest some time after they left the armed forces. In the absence of this budget proposal, the Department of Veterans Affairs will be required to spend billions of dollars on such payments, as a result of a recent legal ruling. (CBO estimates that when phased in fully, this ruling could require the Department of Veterans Affairs to spend as much as $15 billion a year on these payments.) The budget also would secure mandatory savings by reducing the federal share of expenditures for Medicaid and food stamp administrative costs, scaling back the Agriculture Department's Export Enhancement Program and the cotton program, making changes in the student loan program and the FHA single-family loan program, and adopting more aggressive methods to prevent or recover Medicare and SSI overpayments.

In addition, the budget contains reductions in a number of discretionary programs, although the savings these reductions would produce are significantly smaller than those the reductions in entitlement programs would generate. Among the discretionary programs that would be reduced are impact aid, public housing operating subsidies, Small Business Administration disaster loans, Public Law 480 market promotion activities, the Appalachian Regional Commission, construction of veterans' medical facilities, the Army Corps of Engineers, Naval Petroleum Reserve operating costs, and space flight and related activities.

The Net Expansion in Programs Would Be Modest

The program expansions would cost more than the program reductions would save. Expansion costs not paid for by program reductions would be financed primarily by revenues anticipated from tobacco legislation.

The overall net expansion in programs — including the expansion financed with tobacco revenues — would be modest; it would equal between one-tenth and two-tenths of one percent of the Gross Domestic Product in most years. (The Gross Domestic Product, or GDP, is the basic measure of the size of the U.S. economy.) This is *less* than the amount by which federal expenditures otherwise will contract as a share of GDP, due to the strictures of the 1997 budget agreement and continued economic growth. As a result, federal spending will fall as a share of GDP even with the initiatives.

Even with the program expansions, federal spending would decline from 20 percent of the Gross Domestic Product today to 18.8 percent in 2002. *Throughout this period, federal spending as a share of the economy would be at its lowest level since 1974.* (In the absence of the Administration's budget, federal spending would be 18.7 percent of GDP in 2002 under both the CBO and OMB estimates.)

Budget Does *Not* Contain $150 Billion in Increased Program Expenditures

Figures as high as $150 billion have been tossed around for the amount of the new program spending in the Administration's budget. These figures are inflated. Over the four years through 2002, the budget contains $57 billion in new spending. Over the five years through 2003, it contains $82 billion in new spending.

In economic terms, these amounts are modest, as the *Washington Post* noted in a February 3 editorial. The spending increases average about $16 billion a year over the next five years, or between one-tenth and two-tenths of one percent of the Gross Domestic Product. The *Post* editorial commented that "The proposed spending increases are a good deal smaller than the surrounding rhetoric on either side would suggest."

The $150 billion figure that some critics of the budget have cited is based on two problematic uses of data. First, increased expenditures in some programs that are fully paid for by cuts in other programs are counted as new spending. An example illustrates the shortcomings of this approach.

Suppose two programs each cost $300 million in a given year. If they cost the same amount the following year, there is no new spending. Now suppose the government sets priorities, increasing the more effective of the two programs by $100 million and cutting the less-effective program by the same amount. Total costs do not rise. But under the accounting method used by those who contend the budget contains $150 billion in new spending, this shifting of funds between programs is said to constitute $100 million in new spending.

The second problem with the $150 billion number is that it counts the cost of the tax cuts the Administration has proposed. Some who have used the $150 billion figure have made clear this figure includes tax cuts as well as program expansions; others citing this number have not been as careful and have implied the budget contains $150 billion in new spending. In any event, all of the tax cut proposals are paid for by closing various tax breaks.

Determining the actual amount of new spending the budget contains is straightforward. One compares the amount of program spending that would occur if there were no changes in policy to the amount of program spending under the Administration's budget proposals. This shows the budget includes $82 billion in new spending over five years.

As noted elsewhere in this piece, this $82 billion in added program expenditures would be financed primarily from $65.5 billion in payments anticipated as a result of enactment of tobacco legislation. The other $16 billion would come from added revenue raised primarily by reinstating some expired environmental taxes levied on corporations and on hazardous substances and by converting the airline ticket tax to a user fee.

A portion of the $82 billion in added expenditures would be used for activities universally agreed to be a necessary part of any tobacco legislation that can pass, such as relief for tobacco farmers, expanded smoking cessation programs, increased research into tobacco-related health problems, and funds from tobacco legislation that the federal government would pass through to the states.

Taxes Would Decline as a Percentage of Income

The budget contains both provisions that would increase taxes and provisions that would reduce taxes. It raises $23 billion over five years in measures to broaden the tax base (i.e., to close unwarranted or low-priority tax expenditures) and uses these proceeds to finance virtually all of the $24 billion it proposes in new tax cuts.

The budget would result in a net gain of $16 billion over five years in revenue, exclusive of the anticipated tobacco payments. The net gain would come primarily from reinstating an environmental tax that is levied on corporations and used to finance the clean-up of toxic waste sites, along with related excise taxes on hazardous substances that also are used to finance clean-ups (both types of taxes expired at the end of 1995) and from converting the airline ticket tax to a user fee that would somewhat boost government receipts.

The net increase in receipts (exclusive of the tobacco monies) would be very small — about $3 billion a year, or a fraction of one-tenth of one percent of GDP.

Furthermore, over the next five years, the typical family would experience tax reductions, not tax increases. This would occur primarily because the tax cuts enacted as part of last year's budget agreement phase in over a number of years, so that a new tax cut effectively kicks in each year. For example, between 1998 and 1999, the child tax credit will rise from $400 to $500 per child, while the amount of interest payments on student loans that a taxpayer may deduct rises from $1,000 to $1,500. Income limits on tax-deductible contributions to Individual Retirement Accounts also will rise in 1999.

Some argue that the proceeds anticipated from tobacco legislation constitute a tax increase. At present, it is not known whether these proceeds would come in the form of payments from tobacco manufacturers or as an excise tax on tobacco products (the Administration's budget indicates it favors payments from the manufacturers), but the difference is not especially significant from a policy or economic standpoint. There is broad agreement that the principal goal of any tobacco legislation is to reduce smoking, especially among youth, and that one of the principal means of doing so is to raise the price of cigarettes. Extracting payments from tobacco manufacturers (which are then passed through to consumers in the form of higher cigarette prices) and imposing an excise tax on cigarettes are two methods to achieve the same goal — to raise cigarette prices and thereby discouraging smoking.

Policies that raise the price of cigarettes to deter smoking and protect Americans' health are not what most Americans think of when they hear talk of tax increases that cause them to keep less of what they earn. But even if the revenues the Administration anticipates receiving from tobacco legislation *are* counted as new taxes, the percentage of income that Americans pay in taxes still would edge down a bit under the Clinton budget.

Today, federal taxes equal 19.9 percent of the Gross Domestic Product, which essentially means that taxes equal about one-fifth of the national income. The budget shows that even if the tobacco revenues are counted, taxes will edge down slightly to 19.7 percent of GDP in 2002. In four of the next five years, taxes would be lower as a percentage of GDP under the Administration's budget than they are today. (Some Administration critics are citing the single year in which revenues would tick up slightly as a percentage of GDP — that is, 1999 — and not mentioning that the trend would be downward.) The typical family will pay less of its income in taxes, not more.[2]

[2] It is worth noting that Treasury data show the typical or median family now pays a lower percentage of income in federal income and payroll taxes than at any time in the past 22 years.

CENTER ON BUDGET
AND POLICY PRIORITIES

September 10, 1998

MARRIAGE PENALTIES AND BONUSES IN THE INCOME TAX

by Iris J. Lav and Alan Berube

Summary

"Marriage penalty" tax relief is high on the agenda this fall as Congress returns from recess. In this year's budget resolutions and in a variety of subsequent pronouncements by House and Senate Republican leaders on tax cut plans, providing relief from the "marriage penalty" has been mentioned as a priority.

Marriage penalty relief means that federal income taxes would be reduced for married couples who currently owe more tax than they would owe if they were able to file as single individuals. Many marriage penalty reduction proposals, however, are very costly and provide the bulk of their tax relief to higher-income couples who least need it. In addition, a number of proposals increase marriage bonuses for couples that already receive such bonuses under current law.

- Most proposals that significantly reduce marriage penalties are expensive. A proposal by Representative Jerry Weller (R- IL) that is co-sponsored by a majority of House members would allow couples the choice of filing jointly or as two single individuals. This proposal would cost $20 billion a year. Another proposal (also introduced by Representative Weller and referenced in this paper as Weller II) would set the standard deduction for married couples at twice the value for single filers and set the width of the tax brackets (the amount of income taxed at each progressive tax rate) for couples at twice the width of the brackets for single taxpayers. This Weller II proposal would cost $32 billion a year.

- More limited marriage penalty reduction proposals also can carry a significant cost. Various proposals to increase the standard deduction for married couples — such as measures proposed by Representatives Nancy Johnson (R-CT) and Sam Johnson (R-TX), Representative Jim McDermott (D-WA), and Senator Phil Gramm (R-TX) — cost between $4 billion and $9 billion a year.

- High cost marriage penalty reduction provisions might be incorporated into a tax bill in ways that make them appear less expensive, such as with a gradual phase-in. While gradually phasing in these provisions could reduce their cost over the next five or even ten years, the full cost ultimately would be felt when the provisions take full effect.

- Many marriage penalty reduction proposals provide the bulk of their benefits to higher-income families. Weller I and Weller II would each provide over 80 percent of their tax benefits to couples earning more than $50,000 a year. An alternative approach, restoring the two-earner deduction that existed prior to the Tax Reform Act of 1986, also would provide more than 80 percent of its benefits to taxpayers with incomes exceeding $50,000. Yet couples with incomes exceeding $50,000 make up less than half of all joint filers and 20 percent of all taxpaying households.

Most proposals that seek to reduce marriage penalties below their current level do not create a tax code unbiased toward marriage. Instead, they introduce further inequities between single taxpayers and married couples or among married couples with different earnings patterns.

- The current tax system does not penalize marriage overall. The tax code provides more marriage *bonuses* than marriage penalties — that is, there are more couples whose taxes are reduced as a result of marriage than there are couples for whom marriage increases their taxes. Among all families filing joint tax returns, the Congressional Budget Office finds that 51 percent receive marriage bonuses and 42 percent experience marriage penalties. CBO has reported that in 1996, the amount of marriage bonuses exceeded the amount of marriage penalties by $4 billion.

- Moreover, this CBO estimate of marriage bonuses and penalties may undercount the extent to which the current tax system results in marriage bonuses. In deriving this estimate, CBO assumed that prior to marriage, the first child of the couple was on the tax return of the higher-earning spouse, the next child was assigned to the lower-earning spouse, and all additional children were assigned to the higher-earning spouse.

  If marriage penalties and bonuses are calculated under an alternative CBO assumption that all children are claimed by the lower-earning spouse prior to marriage, 57 percent of families have marriage bonuses and 39 percent experience penalties. Under this alternative assumption, marriage bonuses exceed marriage penalties by $30 billion rather than $4 billion. The actual situation is probably somewhere between these two

The Johnson and Johnson Proposal

A proposal to be introduced by Representatives Nancy Johnson (R-CT) and Sam Johnson (R-TX) reportedly reduces marriage penalties by increasing the standard deduction for married couples. The details of the Johnson and Johnson proposal are not available as of this writing.

This report looks at various other marriage penalty reduction proposals that expand the standard deduction. As compared to more far-reaching marriage penalty reductions proposals such as "Weller I" and "Weller II," a standard deduction increase targets a greater proportion of benefits on middle-income taxpayers. Most higher-income taxpayers have enough expenses to itemize their deductions and do not use the standard deduction.

A downside of this approach is that increasing the standard deduction for married couples does not distinguish between couples that need marriage penalty relief and those that do not. As a result, it would substantially increase the size of current-law marriage bonuses for many couples currently receiving such bonuses under current law.

Moreover, a standard deduction increase does nothing to relieve the marriage penalties experienced by low- and moderate-income families that arise from the phase-out of the Earned Income Tax Credit. Additional, specific provisions — such as those included in Senator Phil Gramm's amendment to the McCain tobacco legislation or the McDermott/Neal bill described in this report — are required to extend the marriage penalty tax relief to working families receiving the EITC. It is unclear at this time whether the Johnson and Johnson proposal includes such provisions.

sets of assumptions, although it is likely to be closer to the $30 billion than $4 billion marriage bonus estimate. A Congressional Research Service report points out that it may be more realistic to assume that children are claimed by the lower-earning spouse prior to marriage because 85 percent of children who live with one parent live with the mother.

- Some of the proposals to reduce marriage penalties would further increase the bonuses married couples receive under current law. For example, under the Weller II proposal, which sets the width of the tax brackets and the size of the standard deduction for married couples at twice the values that apply to single filers, a person earning $64,000 who marries a person with no income could see his tax bill decline more than $5,000, a drop of more than 40 percent. Under current law, such a couple already receives a tax bonus if they marry.

  Under this proposal, a married couple with income of $64,000 would pay 41 percent less income tax than a single person with the same income. Such large discrepancies are likely to be viewed as unfair. If enacted into law, they could give rise to future demands for additional tax relief for single taxpayers.

- The Weller I proposal, which provides couples the option of filing jointly or as two single individuals, would not lead to inequities between single people and married couples as Weller II does, but Weller I would create new inequities in the tax code's treatment of different types of married couples.

  Under current law, couples with the same income and circumstances always pay the same amount of tax. Under Weller I, however, married couples with the same income, same number of dependents, and same expenses would pay different amounts of tax, and the discrepancies in tax burdens between couples with the same incomes could be quite large. For example, under the Weller I proposal, a family in which a husband earns $64,000 and the wife does not work would pay $1,400 more in taxes than a couple in which both members work and each earns $32,000. Such discrepancies would likely be perceived as inequitable and could cause single-earner couples to petition for comparably lower tax bills.

Research suggests that marriage penalties and bonuses in the tax code have little effect on marriage rates. To the extent that studies find any effect of tax considerations on the decision to marry, the effect on marriage decisions for every tax dollar foregone has been found to be small. For example, the findings of a recent study by economists James Alm at University of Colorado and Leslie Whittington at Georgetown University imply that eliminating half of the marriage penalties — a slightly greater percentage than are eliminated by Weller II — might over time lead to an increase in the proportion of women between the ages of 15 and 44 who are married from 52.9 percent to 54.2 percent. If the Weller II bill were to produce that result, however, the increased marriages would come at a very high price — the cost to taxpayers would be $380,000 over 10 years for each additional woman who marries.

For these reasons, the case for marriage penalty relief at this time is not strong. If policymakers choose to go down this path, however, there are various ways that marriage penalty relief can be better targeted to the lower- and moderate-income taxpayers for whom marriage penalties represent a larger share of income than they do for higher-income couples. The ways to target relief include: setting specific income limits on who can use marriage penalty relief provisions; allowing a deduction for second-earners with modest wages; changing a provision of the tax code used most heavily by lower- and moderate-income taxpayers; and including specific language and provisions that change the marriage penalties associated with the phase-out of the EITC.

Sources of Marriage Penalties and Marriage Bonuses

Marriage penalties are not an explicit additional tax on joint filers. Instead, they arise when a couple experiences a greater tax liability than it would if the two members were to file as single individuals. These penalties are created by provisions throughout the federal income tax code designed to treat the combined income of joint filers differently than the income of two single filers. The most widely used provisions that may give rise to these penalties are the standard deduction and the joint filer tax brackets.

The standard deduction is $4,250 for single filers and $7,100 for joint filers in 1998. So two unmarried people filing as single individuals will together have claimed standard deductions of $8,500, but must use the joint filer standard deduction of $7,100 after they marry. The smaller standard deduction results in larger taxable income and thus a higher tax.

Similarly, the amount of taxable income taxed at each of the progressive tax rates — 15 percent, 28 percent, 31 percent and so on — is different for single taxpayers and joint filers. For single filers, the 15 percent tax rate is applied to all taxable income up to $25,350 in 1998. So two unmarried single filers could each have as much as $25,350 taxed at the 15 percent rate, for a total of $50,700 taxed at 15 percent. If the two individuals marry, however, the amount of their taxable income that is taxed at the 15 percent rate would decline to $42,350. The remainder would be taxed at the 28 percent rate, creating a "marriage penalty." (See Table 1. Note that *taxable income* means income after deductions and exemptions have been subtracted. Married couples typically have adjusted gross income much higher than $42,350, and singles have income above $25,350, before they fall into the 28 percent brackets.)

On the other hand, some couples marry and receive a "marriage bonus." For example, under current law there would be a large tax savings if a single person with taxable income of $40,000 married a person who is not working because he or she is in school or caring for a child. Before marriage, nearly $15,000 of the worker's taxable income would have been taxed at the 28 percent rate. After marriage, all of the income is taxed at the 15 percent rate.

Whether the couple experiences a net loss due to joint filing (a marriage penalty) or a net gain (a marriage bonus) depends on the distribution of earnings between the spouses. Couples in which earnings are split relatively equally between husbands and wives are more likely to experience marriage penalties. Couples in which one member has little or no earnings will generally have marriage bonuses.

Table 1
1998 Federal Income Tax Parameters

	Single Filers	Joint Filers
	Taxable Income*	
15% rate applicable:	$0 to $25,350	$0 to $42,350
28% rate applicable:	$25,351 to $61,400	$42,351 to $102,300
31% rate applicable:	$61,401 to $128,100	$102,301 to $155,950
36% rate applicable:	$128,101 to $278,450	$155,901 to $278,450
39.6% rate applicable:	$278,451 and up	$278,451 and up
Standard deduction:	$4,250	$7,100

*Taxable income is income after deductions and exemptions have been subtracted. For example, a couple with two children earning $60,000 would have taxable income of no more than $42,100 after subtraction of the standard deduction of $7,100 and personal exemptions of $10,800. Taxable income could be less if the couple itemizes deductions rather than using the standard deduction. All of this couple's taxable income would be taxed at the 15 percent rate.

Low-income Marriage Penalties and Bonuses

Low-income families sometimes face marriage penalties or bonuses that stem largely from a different provision of the tax code, the Earned Income Tax Credit. For many low-income families, the combination of the personal exemptions, the standard deduction, the child credit, and (if applicable) the dependent care credit eliminates their income tax liability; these features of the tax code cannot cause marriage penalties. But the structure of the Earned Income Tax Credit affects these families.

The Earned Income Tax Credit for families with children is a refundable credit for low- and moderate-income taxpayers who have earnings from work. The credit is structured so it phases out gradually for families with incomes in excess of a specific level. In 1998, the phase-out range begins when gross income reaches $12,260 and continues through gross income of $26,473 for families with one child and $30,095 for families with two or more children. Figure 1 illustrates the structure of the EITC. To the extent that combining the earnings of two people as a result of marriage boosts their income to a point in the phase-out range at which they receive a smaller credit than one or both of them would have received if still single (or raises their income to a level that makes them ineligible for the EITC), the family can be said to experience a marriage penalty.

A low-income marriage penalty related to the EITC would occur, for example, if a low-income man married a low-income woman who had similar earnings and was raising two children. Table 2 shows how the marriage penalty comes about for such a man and woman if they each work full time throughout the year at the federal minimum wage. If unmarried, the man would file as a single taxpayer, while the woman would file as a head of household and claim an EITC for her two children. When they are unmarried, the man pays $564 in income tax while the woman qualifies for a $3,756 refund — the maximum EITC for a family with two children in 1998. Their combined refund thus is $3,192. If they marry, the couple's combined income of $21,424 puts them in the phase-out range of the EITC. As a result, their combined refund is reduced from $3,192 to $1,826, yielding a marriage penalty of $1,366.

The EITC creates marriage bonuses as well as marriage penalties. When a person raising a child has little or no earnings and marries someone who has modest earnings, the family could become newly eligible for an EITC or eligible for a larger EITC and thus receive a sizeable marriage bonus.

Consider, for example, the father and mother of two children who are not married and live apart. The mother stays at home to care for the children and does not work; she may live with her parents or receive welfare payments. Since the mother does not have earnings from work or any other taxable income, she pays no income tax and receives no EITC. The father works but cannot receive the EITC for his children because he does not live with them. If the father earns $21,400 a year, he would pay $2,168 in income tax. If he marries the mother of his children, however, the family would receive a $1,831 refund. In this case, marriage resulted in a marriage bonus of $3,999, primarily as a result of the EITC. (See Table 3.)

Most of the marriage penalty reduction proposals that have received widespread attention — including proposals that change the applicable tax rates or enlarge the standard deduction — would do little or nothing to address the marriage penalties associated with the EITC. Two separate proposals by Senators Phil Gramm and Tom Daschle that the Senate considered earlier this year during debate on tobacco legislation did, however, address EITC-related marriage penalties. Specific strategies such as those included in the Gramm or Daschle bills are required to address penalties that result from the phase-out structure of the EITC. These are discussed below in the section entitled "Addressing Marriage Penalties in the EITC."

Table 2
Low-Income Marriage Penalty Example
1998 Taxes

	Man (no children)	Woman (2 children)	Couple (2 children)
Income	$10,712	$10,712	$21,424
Exemptions	($2,700)	($5,400)	($10,800)
Standard Deduction	($4,150)	($6,250)	($7,100)
Taxable Income	$3,762	$0	$3,528
Tax (at 15%)	$564	$0	$529
Child Credit	$0	$0	$529
Tax after Child Credit	$564	$0	$0
EITC	($0)	($3,756)	($1,826)
Liability/(Refund)	$564	($3,756)	($1,826)
Combined Refund	($3,192)		($1,826)
Marriage Penalty			**$1,366**

Marriage Penalty Reduction Proposals

A number of different types of proposals to reduce or eliminate marriage penalties have been discussed. As of this writing, it is unclear which of these proposals might be included in House or Senate Republican leaders' tax proposals. This paper focuses on two proposals we call "Weller I" and "Weller II" because these bills have been the most widely discussed and supported approaches to eliminating portions of marriage penalties. Other approaches are described in the box on pages 11-12.

"Weller I"

A proposal that has attracted a significant amount of attention and support — it has 238 cosponsors — is H.R. 2456, the Marriage Tax Elimination Act. (Called "Weller I" in this report.) Sponsored by Representative Jerry Weller (R-IL), the bill would give married couples two different options for filing their taxes. The couples could file

Table 3
Low-Income Marriage Bonus Example
1998 Taxes

	Man (no children)	Woman (2 children)	Couple (2 children)
Income	$21,400	$0	$21,400
Exemptions	($2,700)	($0)	($10,800)
Standard Deduction	($4,150)	($0)	($7,100)
Taxable Income	$14,450	$0	$3,500
Tax (at 15%)	$2,168	$0	$525
Child Credit	$0	$0	$525
Tax after Child Credit	$2,168	$0	$0
EITC	($0)	($0)	($1,831)
Liability/(Refund)	$2,168	$0	($1,831)
Marriage Bonus			**$3,999**

jointly, as the vast majority of couples do under current law. Alternatively, couples would have a new option under which a husband and wife could file as if they each were single individuals, but they would file together on the same tax return. Under the latter option, each spouse would report his or her earnings and other income separately; unearned income such as investment income would be allocated according to a set of detailed rules. Each spouse's income would be taxed using the deductions and rates applicable to single persons.[1]

[1] The separate filing option would allocate unearned income, such as that received through investments, to the spouse that owns those investments. Thus, if an asset like a home or a stock portfolio is in only one spouse's name, that spouse would pay the taxes on all proceeds from the sale of that asset. If a couple itemized deductions rather than took the standard deductions, itemized deductions that apply to both spouses (the mortgage interest on a jointly-owned home, for example) would be allocated based on each spouse's share of total income. Thus, a spouse reporting $60,000 in income out of the couple's combined income of $80,000 would be allowed 75 percent of the deductions resulting from jointly-incurred expenses. The exemptions for dependents also would be allocated in this manner.

Once each spouse determines his or her taxable income, the income tax would be determined by applying the single filer tax brackets and tax rates. After that point in the tax calculation, however, the spouses would be treated as joint filers. Tax credits would be subtracted from the joint liability of the couple, as if the spouses had filed a joint return.

The Weller I approach gives each couple the opportunity to make two different tax calculations and to pay the lower of the two taxes. As a result, couples that get a marriage bonus under current law would continue to do so. Some couples that experience marriage penalties under current law would see their tax bill drop.

This Weller separate-filing option does nothing to reduce or eliminate marriage penalties experienced by low-income working families as a result of the Earned Income Tax Credit phase-out. For purposes of computing tax credits, the Weller scheme treats the couple as filing a joint return, identical to the way that couples are treated under current law. Once the taxable income and amount of income tax for each member of a couple choosing the separate filing option is determined, the amount of taxes owed by each member of the couple is added together and current joint filing rules for computation of tax credits are employed.

As a result, a couple with income of $300,000, half of which is earned by husband and half by the wife, would have its marriage penalty of slightly more than $7,500 a year eliminated under the Weller separate filing option. But a family with income of $21,400, in which the husband and wife each work full time at the minimum wage, would continue to pay its nearly $1,400 marriage penalty.

Weller I would add a substantial amount of complexity to the tax calculation and could increase tax calculation errors. Many couples would calculate their taxes under each alternative and then select the smaller liability. Moreover, as noted, the proposal requires detailed rules for allocating unearned income from joint investments, itemized deductions resulting from joint expenses, and exemptions for children.

Weller I also would create some additional tax inequities that do not exist under current law between couples in which one spouse is the sole or primary bread-earner and two-earner couples whose income is more evenly derived from each spouse's earnings. Under current law, all couples with the same taxable income — that is, the same income, number of dependents, and deductible expenses — pay the same amount of income tax. Weller I reduces taxes, however, only for couples in which both spouses are working. Reducing taxes for dual-earner couples but not single-earner couples means that some families with "stay-at-home moms" would pay higher taxes than families with the same taxable income and both spouses in the workplace.

Some supporters of marriage penalty relief — particularly those of a more socially conservative viewpoint — have considered it problematic to favor dual-earner couples over couples in which the wife is a homemaker. As a result, alternative proposals have been introduced to allow couples to split their earned and unearned income and file as individuals regardless of which member earned the income. The

Major Marriage Penalty Reduction Proposals

Legislators in the 105th Congress have offered a number of proposals to reduce marriage penalties. The major approaches to marriage penalty relief under consideration and the bills that would implement those approaches are described below.

"Weller I" — Allow couples the option to file as singles. H.R. 2456, the Marriage Tax Elimination Act, was introduced by Rep. Jerry Weller (R-IL) and is co-sponsored by 238 members. (A counterpart bill, S. 1314, is sponsored by Senator Kay Bailey Hutchison (R-TX) in the Senate.) This bill would give married couples the option of filing either jointly or as single individuals on the same tax return. For couples choosing the single-filing option, the husband and wife each apply to his or her own income the standard deduction and rate schedule applicable to single individuals; they thus would have the same tax liability as when single. The bill adds significant complexity to the tax calculation because many spouses would calculate their taxes under each alternative and then select the smaller liability. In addition, this proposal requires detailed rules for allocating unearned income from joint investments, itemized deductions resulting from joint expenses, and exemptions for children. For purposes of calculating the Earned Income Tax Credit and other credits, the couple is treated as if it had filed a joint return. As a result, this bill does not relieve marriage penalties for most low-and moderate-income taxpayers that arise from the structure of the EITC. *Cost: $20 billion a year (Joint Committee on Taxation).*

Riley — Allow couples to split their income equally. H.R. 3104, sponsored by Rep. Bob Riley (R-AZ), would allow couples to split their combined taxable income into two equal parts regardless of which member of the couple earned the income. Senator John Ashcroft (R-MO) has introduced a similar bill (S. 2312). Each spouse would compute the tax on his or her half of the couple's joint income based on the rates applicable to single filers. For dual-income couples, this bill would reduce marriage penalties in the much the same way as Weller I. Unlike Weller I, however, the Riley bill also would cut taxes for many couples currently receiving a marriage bonus. A one-earner couple with $50,000 in taxable income for which some portion of the income is taxed at the 28 percent marginal rate could split its income, with the result that all of the income would be taxed at the 15 percent rate. This bill also would increase the size of the standard deduction for married couples to twice the size of the standard deduction for single filers. Like Weller I, the Riley bill computes credits based on joint tax liability and consequently offers little marriage penalty relief to low-and moderate-income taxpayers. *Cost: $31 billion a year (Joint Committee on Taxation).*

"Weller II" — Increase the size of joint filer brackets and standard deduction. H.R. 3734, also offered by Representative Weller, would have much the same effect as the Riley bill. The tax brackets — the amount of income that is taxed at each progressive rate — for joint filers would be set to double the width of the brackets for single filers. As under the Riley income-splitting approach, a couple would have twice as much income taxed at the 15 percent rate, and each subsequent rate, as a single person would. The standard deduction for a joint filer also would be increased to twice the standard deduction for a single person. This would alleviate marriage penalties that sometimes occur when two individuals with earnings marry. It also would increase marriage bonuses for one-earner couples and other couples that already receive tax reductions under current law when they marry. Like Weller I and Riley, Weller II offers little marriage penalty relief to low-and moderate-income taxpayers. The Senate counterpart to Weller II is S. 1999, sponsored by Senator Kay Bailey Hutchison. *Cost: $32 billion a year (Rep. Weller).*

Herger — Restore the two-earner deduction. From 1982 through 1986, a provision existed in the tax code that allowed married couples to deduct from their joint income a portion of the lower-earner's income. The two-earner deduction, as it was called, was eliminated in 1986 as part of the 1986 Tax Reform Act's simplification measures. H.R. 2593, sponsored by Rep. Wally Herger (R-CA), would restore that provision, granting married couples a deduction equal to the lesser of $3,000 or 10 percent of the lower-earning spouse's income. Couples would not have to itemize deductions to claim this two-earner deduction. *Cost: $9 billion a year (Joint Committee on Taxation).*

Daschle — Two-earner deduction. The Herger bill does little to assist low- and moderate income couples that experience marriage penalties associated with the EITC structure. In contrast, a bill introduced by Senate Minority Leader Tom Daschle that restores a two-earner deduction for couples with incomes below $60,000 (S. 2147) includes specific language that would make the deduction applicable to couples receiving the EITC for families with children. This deduction would have the effect of increasing the amount of the Earned Income Tax Credit received by two-earner couples, thereby alleviating marriage penalties for these low- and moderate-income working families. *Cost $3 billion a year. (Senator Daschle)*

McDermott/Kleczka and Neal/McDermott — Increase the size of the standard deduction and increase the income level at which the EITC phase out begins for joint filers. Two complementary bills introduced by Rep. Jim McDermott (D-WA), address marriage penalties that affect some middle- and low-income taxpayers. H.R. 3524 (McDermott/ Kleczka) would increase the size of the standard deduction for joint filers to double that of single filers. In contrast to Weller II, however, it would not change the width of the tax brackets. This would provide a modest reduction in marriage penalties for many moderate- and middle-income couples. It also would increase the size of current-law marriage bonuses for other couples. H.R. 3995 (Neal/McDermott) would reduce marriage penalties that arise from the structure of the Earned Income Tax Credit by creating a separate EITC computation for joint filers that increases the amount of income the couple can earn before the EITC begins phasing out. *Cost: H.R. 3524 - $4 billion a year; H.R. 3995 - 2.6 billion a year. (Rep. McDermott and Rep. Neal)*

Gramm/Domenici — Increase the standard deduction for married couples and allow increase to benefit families claiming an EITC. An alternative method of allowing low- and moderate-income families to benefit from an increase in the standard deduction was included in an amendment to tobacco legislation introduced earlier this year by Senator Phil Gramm (R-TX) and Senator Pete Domenici (R-NM) and passed by the Senate. That amendment increased the standard deduction for married couples with incomes below $50,000 and, like the Daschle bill described above, included specific language to allow the increase to benefit families receiving the EITC. *Cost: approximately $9 billion year. (Sponsors' fact sheet)*

Table 4
Marriage Penalties and Bonuses Under Alternative CBO Assumptions

	Children assigned to both parents (primary CBO assumption)*	Children assigned to lower-earning spouse
Percentage of Couples with Penalties and Bonuses		
With Penalties	42%	39%
With Bonuses	51%	57%
Total Penalties and Bonuses (Billions of dollars)		
Penalties	$28.8	$25.2
Bonuses	$32.9	$55.2
Net Bonus	$ 4.1	$30.0

*To calculate marriage penalties and bonuses, assumptions must be made about how children were reflected on tax returns prior to marriage. The assumption used for most of the calculations in the CBO report is as follows: the first child is assigned to the spouse with higher earnings, the second to the lower-earning spouse, and all others to the higher earner. An appendix to the CBO report shows marriage penalties and bonuses under an alternative assumption that all children are assigned to the lower-earning spouse. The actual situation is probably somewhere between these two sets of assumptions. Note that these calculations are for 1996 taxes and do not include the impact of the child tax credit enacted in 1997.

Source: Congressional Budget Office, *For Better or For Worse: Marriage and the Federal Income Tax*, June 1997.

rules for allocating income between the spouses for purposes of income splitting, however, are quite complex. (See description of Riley bill in box on pages 11-12.)

"Weller II"

A less complex approach that produces results similar to allowing all couples to split their income regardless of which spouse earned the income is embodied in another bill — H.R. 3734, the Marriage Tax Penalty Elimination Act — also sponsored by Representative Weller. This "Weller II" proposal would expand the size of the joint filer tax brackets and standard deduction so they would be exactly twice the size of those for single filers. Accomplishing much the same goal as income splitting, it would allow two people each with income near the upper limit of a tax bracket to marry and still have all their income fit within this same, lower tax bracket.

Unlike Weller I, which allows each spouse to make a separate calculation based on his or her own earnings and thus assists only dual-earner couples, the Weller II approach also would lower the taxes of single-earner couples. As noted above, single-earner couples generally receive marriage bonuses under current law. Under Weller II, the size of the marriage bonus single-earner families already receive would substantially increase.

Like Weller I, the Weller II proposal does nothing to lower marriage penalties of most lower-income working families who receive the Earned Income Tax Credit. While the expansion of the standard deduction for married couples might seem to benefit lower-income families, most EITC recipients already have all their pre-EITC tax liability eliminated by a combination of the personal exemptions, the current standard deduction, and the child credit enacted in 1997. Thus, a larger standard deduction provides no additional benefit to them.

Current Law Balances Marriage Penalties and Marriage Bonuses

There is a fundamental question of whether sweeping marriage penalty relief is needed or desirable at this time. Research by the Congressional Budget Office shows that overall, the current tax system does not penalize marriage. Although nearly 21 million couples incurred marriage penalties averaging nearly $1,400 apiece in 1996, another 25 million couples received bonus averaging $1,300 apiece. An additional three million couples incurred neither penalties nor bonuses. Among all families filing joint tax returns, the Congressional Budget Office finds that 51 percent receive marriage bonuses and 42 percent experience penalties. In 1996 the amount of marriage bonuses exceeded the amount of marriage penalties by $4 billion.[2]

In calculating these marriage penalties and marriage bonuses, CBO made an assumption that has the result of substantially understating marriage bonuses. CBO assumed that prior to marriage, the first child of the couple was on the tax return of the higher-earning spouse, the next child was assigned to the lower-earning spouse, and all additional children were assigned to the higher-earning spouse. The CBO report also provides information on total marriage penalties and bonuses under an alternative assumption, that all children are the dependents of the lower-earning spouse. The actual situation is somewhere between the two assumptions, but probably closer to the

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[2] For the purpose of calculating the tax that would be owed if couples were not married, the Congressional Budget Office assumes spouses each take their own earnings and divide unearned income and itemized deductions in proportion to their earnings. The first child is assigned to the spouse with higher earnings, the second to the lower-earning spouse, and all others to the higher earner. If eligible, both spouses can file as head of household. Congressional Budget Office, *For Better or For Worse: Marriage and the Federal Income Tax*, June 1997.

alternative assumption because 85 percent of children who live with one parent live with their mother.[3]

If all children are assumed to be with the lower-earning spouse prior to marriage, marriage bonuses substantially exceed marriage penalties under current tax law. Under this alternative CBO assumption, 39 percent of families have marriage penalties and 57 percent have marriage bonuses. The amount of marriage bonuses exceeds the amount of marriage penalties by $30 billion.

These comparisons make it clear that a balance has been struck in the tax code between marriage penalties and marriage bonuses. If anything, the balance tilts toward providing significantly more marriage bonuses than marriage penalties. The major marriage penalty reduction proposals under consideration would alter this balance. In doing so, these proposals would introduce significant new inequities into the income tax system.

Marriage Penalty Legislation Could Create New Inequities

Marriage penalties and bonuses are the result of a compromise between competing goals of the tax code. If the tax code levies the same tax on all married couples with the same income and circumstances, as is the case under current law, then the tax liability of two people who marry often will necessarily be different — higher or lower — than it was when they were single. The current tax code achieves the goal of *tax parity*, treating all married couples with the same income alike. But the current tax system is not marriage-neutral, because single and married people with the same income pay different amounts of tax. Alternatively, if the tax code were to require all people to file as individual taxpayers and eliminate marriage penalties and bonuses, married couples with the same income would have different tax liabilities depending on the portion of the total income the husband and wife each earned. *Marriage neutrality* would be achieved at the expense of tax parity.

Table 5 illustrates these tradeoffs for two couples that each have total wages of $64,000 but have different earnings patterns. It also provides similar information for two couples with total income of $300,000. In each case, the couple is assumed to have no children. (The calculations behind Table 5 are detailed in the Appendix to this report.)

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[3] Jane Gravelle, *The Marriage Penalty and Other Family Tax Issues*, Congressional Research Service, August 4, 1998.

Table 5
Trade-Offs Between Tax Parity and Marriage Neutrality

	1998 Tax Liability Under Different Proposals			
	Current Law		**Weller I**	**Weller II**
	Single	**Married**	**Married**	**Married**
Two People Each Earning $32,000	$7,515	$8,915	$7,515	$7,515
Bonus or (penalty)		($1,400)	0	0
Single Earner $64,000	$12,679	$8,915	$8,915	$7,515
Bonus or (penalty)		$3,764	$3,764	$5,164
Two People Each Earning $150,000	$76,373	$83,086	$76,373	$76,373
Bonus or (penalty)		($6,713)	0	0
Single Earner $300,000	$88,007	$83,086	$83,086	$76,373
Bonus or (penalty)		$4,921	$4,921	$11,634

The first line of Table 5 shows a couple in which the man and the woman each earn $32,000. The second line shows a couple in which one person making $64,000 marries someone who has no income. (Although a person with no income may be an unusual circumstance, similar results would occur if the second person's income is small relative to the income of the primary earner.)

Under current law, marriage increases the tax bill of the couple in which each spouse earns $32,000 by $1,400 or 19 percent. Both Weller I and Weller II would eliminate this marriage penalty, allowing the couple to pay the same amount of taxes after marriage as before.

When the couple in which one spouse earns the entire $64,000 is considered, the picture is different. Under current law, these individuals already receive a tax bonus of nearly $3,800 when they marry, seeing their taxes reduced 30 percent from $12,679 to $8,915. The Weller I proposal would maintain this marriage bonus, while Weller II would substantially increase it.

Table 5 also indicates how the Weller I proposal creates tax disparities among couples with identical incomes. The couple in which each member earns $32,000 would pay $7,515 in tax, while the couple in which one spouse earns $64,000 would pay tax of $8,915. The single-earner married couple would pay 19 percent more tax than the dual-earner married couple.

The Weller II proposal does not favor dual-earner married families over single-earner married families; as under current law, all married couples with the same taxable income would pay the same tax. But Weller II tips the balance in a different direction, because Weller II increases the marriage bonus for the one-earner couple. In this example, marriage causes the taxes of the one-earner couple to drop by $5,164, from $12,679 to $7,515.

If the enhanced marriage bonus under Weller II is considered from the perspective of a single individual, it looks like a large "singles penalty." The married couple would pay 41 percent less tax than the single individual with the same income.

Singles Penalties

If a tax system has large marriage bonuses, that means it also imposes a large penalty for being single. Two people working next to each other, each earning $64,000, would have very different tax liabilities depending on whether or not each was married. If the Weller II proposal were enacted, a married person would pay tax of $7,515, while a single person with the same income would pay tax of $12,679. Earning the same $64,000, the taxes of the single person would be 69 percent greater than the taxes of his or her married co-worker.[4]

Large "singles penalties" — the flip side of marriage bonuses — are likely to be perceived as unfair by people who remain or become single for a variety of reasons. Of all people between the ages of 20 and 64, more than one-third (36 percent) are not married. Although some of the unmarried third of the working-age population undoubtedly are couples living together who could choose marriage, that option

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[4] Some might argue that married couples *with children* have higher expenses than single people and thus need lower taxes. But there are features of the tax code other than the standard deduction and tax bracket, that under current law adjust for child-related expenses. Families with children may take additional personal exemptions for dependents, the child credit, the dependent care credit and, if qualified, the Earned Income Tax Credit. These specific tax reductions available to families with children represent a more efficient way to adjust for child-rearing costs.

A similar argument might be made with respect to whether two earner married families should have lower taxes than single earner families, some may argue lower taxes are warranted to compensate for the higher expenses of working. To the extent those expenses are child-care related, a significant share would be covered by the dependent care credit that is available solely to two-earner couples.

Table 6
Percent of All Marriage Penalties
By Income Class

Adjusted Gross Income:	Percentage of Tax Returns With Penalties	Percentage of Overall Penalty Amount Each Income Group Pays
Less Than $20,000	5%	3%
$20,000 - $50,000	39	33
$50,000 - $100,000	43	39
$100,000 and Over	13	25

Source: Congressional Budget Office, *For Better or For Worse: Marriage and the Federal Income Tax*, June 1997.

probably is not the situation of the vast majority of the single people for whom "singles penalties" would be increased.[5]

Objections to singles penalties have played a significant role in prior changes in tax policy. The tax system established by the Revenue Act of 1948 biased the tax system greatly against single taxpayers. In response to prior tax law, under which married couples with the same income paid substantially different amounts of taxes, the 1948 law established mandatory joint filing for couples. It set the joint filer brackets and standard deductions for couples at levels double those for single filers, creating an arrangement similar to the one envisioned in the Weller II bill. As a result, the 1948 act created very large marriage bonuses for some couples, similar to those the Weller II proposal would create.

Over the next 20 years, single taxpayers grew increasingly unhappy with the large "singles penalties" the 1948 act imposed on them. Their discontent culminated in legislation in 1969 to reduce large marriage bonuses. The Tax Reform Act of 1969 created new tax brackets for single filers that reduced their taxes and limited differentials between single individuals and married couples with the same taxable income. No new taxes were imposed on joint filers as a result of the change, but the

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[5] Of the 79.6 million non-elderly households in the country, 46.2 million are married couple households and 33.4 million include only single people. Of the 33 million non-married households, only 4.0 million are unmarried couple households.

reduction in taxes paid by single individuals created some marriage penalties for married couples in which each spouse earned similar amounts of income. It also created marriage bonuses for couples in which one spouse earned the bulk of the income.

The balance among the treatment of married couples with different income patterns and between married couples and single individuals that was established in 1969 continues to be reflected in the current tax code. Some couples experience marriage penalties, but more have marriage bonuses. There are some singles penalties, but singles penalties are not as great as they would be if marriage penalties were eliminated.

If the balance is disturbed, the group disadvantaged by the change is likely soon to be asking for further tax relief. If the Weller I proposal were enacted, married couples in which only one spouse works or in which one spouse had substantially greater earnings that the other would likely make their voices heard. Under Weller II, single people would have a basis for pushing for additional tax relief on equity grounds.

Marriage Penalty Tax Cuts Primarily Benefit High-Income Households

The leading marriage penalty proposals would lower taxes primarily for higher income families. The majority of marriage penalties occur among higher-income couples, while more lower-income families have marriage bonuses.

Table 6 shows the distribution of marriage penalties by income. A tax return is said to include a marriage penalty if the couple pays higher taxes than each of the spouses would separately pay if they were allowed to file under the rules that apply to single individuals or heads of household. It shows that 64 percent of the amount of all marriage penalties are incurred by couples with adjusted gross incomes exceeding \$50,000. Taxpayers with adjusted gross incomes exceeding \$50,000 constitute less than half (43 percent) of all joint filers and 20 percent of all taxpaying households.

Under broad marriage penalty relief proposals such as the Weller bills, the benefits of the tax relief would be skewed more sharply toward higher-income taxpayers than the distribution of the marriage penalties themselves would suggest. In part, this is because proposals such as Weller I and Weller II do not relieve the marriage penalties experienced by low- and moderate-income families as a result of the EITC phase-out structure.

Table 7
Marriage Penalties as a
Percentage of Income for Affected Couples

Adjusted Gross Income	Penalties as a Percentage of Income for Couples with Penalties
Less than $20,000	7.6%
$20,000 to $50,000	3.2%
$50,000 to $100,000	1.7%
$100,000 and over	1.4%
All Incomes	2.0%

Source: Congressional Budget Office, "For Better or For Worse: Marriage and the Federal Income Tax", June 1997.

The Congressional Budget Office finds that the Weller II approach, for example, would provide 87 percent of its benefits to families with incomes exceeding $50,000. Restoring the two-earner deduction that existed prior to the Tax Reform Act of 1986 that allowed a deduction of 10 percent of the lower-earning spouses income up to a maximum deduction of $3,000, the approach that H.R. 2593 sponsored by Representative Wally Herger takes, would provide 82 percent of its benefits to taxpayers with incomes exceeding $50,000.

A strong argument can be made that the taxpayers targeted for relief under these types of marriage penalty relief proposals are those least in need of relief. When lower-income taxpayers experience marriage penalties, the penalties tend to represent a much higher proportion of their income than do the marriage penalties that higher-income taxpayers face. Table 7 shows the size of marriage penalties in 1996 for different income groups. The largest marriage penalties, measured as a percentage of adjusted gross income, are incurred by households that would receive little benefit from these proposals — those earning less than $50,000. The average penalty as a percentage of income for those couples making less than $20,000 that have marriage penalties was about five times as large as the average penalty for couples that experience a penalty and have incomes exceeding $50,000.

The leading proposals to reduce marriage penalties continue the recent pattern of targeting tax relief primarily at higher-income individuals. The higher-income couples that would benefit most from many of the marriage penalty reduction proposals are the same taxpayers that are receiving the lion's share of the tax cuts under last year's balanced budget agreement. Low- and moderate-income working families are receiving little tax relief from the Taxpayer Relief Act of 1997. According to a Treasury Department analysis, more than half the 1997 tax cut is going to the 20 percent of families with the highest incomes. By contrast, less than one percent of the tax reductions enacted in the 1997 bill is going to the lowest-income 20 percent of families, and just 7.5 percent of the total tax reduction is going to the lowest-income 40 percent of families.[6]

More Targeted Proposals

The case for enacting marriage penalty relief is not strong. If policymakers do choose to reduce marriage penalties, however, there are various ways that marriage penalty proposals can be better targeted to the taxpayers that arguably are in greatest need of relief.

- A larger proportion of the benefits of the tax relief could be targeted on moderate- or middle-income taxpayers if the marriage penalty relief were accomplished by changing a provision of the tax code that is used most heavily by those taxpayers, such as the standard deduction. Note, however, that most such proposals also increase marriage bonuses for couples that currently receive such bonuses under current law.

- Tax relief can be better targeted on families that experience marriage penalties by structuring a second-earner deduction in a way that targets relief to second-earners with low or moderate wages.

- All of the benefits of marriage penalty reduction could be directed to moderate- and middle-income taxpayers by including specific income limits on who can use the marriage-penalty relief provisions. That also would reduce the cost of the tax relief.

- Marriage penalty tax relief could be targeted on low- and moderate-income families by including specific language and provisions that lessen the marriage penalties associated with the phase-out of the EITC.

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6 The Treasury analysis understates the extent to which the legislation benefits the highest-income taxpayers, because it does not include the effects of the reductions in estate taxes included in the 1997 legislation. The estate tax reduction benefit the heirs only of the wealthiest two percent of individuals who have died. An analysis of the 1997 Tax Act by Citizens for Tax Justice, which includes the estate tax provisions, finds that 78 percent of the benefits of the tax cut enacted in 1997 is going to the highest-income 20 percent of families.

Increasing the Standard Deduction for Couples

A bill introduced by Reps. Jim McDermott (D-WA) and Gerald Kleczka (D-WI), H.R. 3524, would increase the size of the standard deduction for joint filers to double that of single filers. Unlike Weller II, it would not also enlarge the width of the tax brackets. This approach targets a greater proportion of benefits on middle-income taxpayers, because most higher-income taxpayers have enough expenses to itemize their deductions and do not use the standard deduction. (A companion bill described below extends the relief to low- and moderate-income taxpayers that receive the EITC.)

A downside of this approach is that increasing the standard deduction for married couples does not distinguish between couples that need marriage penalty relief and those that do not. As a result, it would substantially increase the size of current-law marriage bonuses for couples currently receiving such bonuses under current law.

According to Rep. McDermott, the cost of this approach would be approximately $4 billion a year. As described below, the companion measure for lower-income households receiving the EITC would cost an additional $2.6 billion a year, for a total cost of approximately $6.6 billion a year.

A somewhat different version of a standard deduction increase was introduced by Senators Phil Gramm (R-TX) and Pete Domenici (R-NM) as an amendment to the McCain tobacco legislation. The Gramm amendment would increase the standard deduction for married couples with incomes below $50,000. It included specific language to allow the increase to benefit families receiving the EITC. The sponsor's fact sheet indicated the cost would be $9 billion a year when fully in effect.

Re-instituting a Two-earner Deduction with Income Limits

Between 1982 and 1986, a two-earner couple could deduct from income 10 percent of the lower-earning spouse's earnings, up to a maximum of $3,000. The cost of fully restoring the deduction, as proposed in the Herger bill, would be approximately $9 billion a year. As noted above, the benefits of the restoration could not be well targeted with respect to income; 82 percent of the benefits would go to taxpayers with incomes exceeding $50,000. No relief would be available to families that experience EITC-related marriage penalties.

In contrast, a measure introduced by Senate Minority Leader Tom Daschle during consideration of tobacco legislation in the Senate (S. 2147) would allow a deduction of 20 percent of the lower-earning spouse's earnings, but only for couples with adjusted gross income below $60,000. This proposal would not increase marriage bonuses, and it would target all of the benefits of marriage penalty reduction on families with income below $60,000. It also incorporates a provision that makes the marriage penalty reduction applicable to families receiving the EITC.

Because it lowers taxes only for two-earner couples and is specifically targeted on moderate- and middle-income families, the Daschle approach costs less than either the McDermott or Gramm measures. The Daschle approach would cost approximately $3 billion a year.

Structuring a Deduction to Assist Low-Wage Second Earners

While the Daschle approach targets all of its relief on families with gross income below $60,000, it provides much smaller relief to low-income families than to those closer to its income ceiling. A family in which one spouse earns $25,000 and the other works part time and earns $5,000, for example, would be able to deduct $1,000 (since this is 20 percent of the lower-earning spouse's wages). By contrast, a family in which each spouse earns $25,000 would be able to deduct $5,000.

An alternative approach could provide more assistance to second-earner spouses with low earnings. If the deduction were set at 100 percent of the lower-earning spouse's earnings up to a specified amount — instead of 20 percent of the lower-earning spouses' earnings — the deduction would be better targeted on lower-income families.[7] For example, the standard deduction could be increased by 100 percent of the lower-earning spouse's wages up to $1,400. (The $1,400 figure is used because it is the amount by which the standard deduction for two individuals filing singly exceeds the standard deduction for a married couple fining jointly.) To maintain targeting, this type of deduction would have to be limited to families with income under a specified ceiling.

Various other combinations of approaches are possible. A two-earner deduction could be structured to allow a deduction of 100 percent of the lower-earning spouse's wages up to a higher amount, such as $2,000 or $3,000. Or, one could allow some percentage of the lower-earning spouse's wages that is between the 20 percent in the Daschle measure and the 100 percent deduction for the specified amount of earnings, such as 50 percent of the lower-earning spouse's wages up to a specific amount such as $3,000. To bring any of these approaches within the desired cost of tax relief, the maximum deduction, the income ceiling, or both could be adjusted.

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[7] Jane Gravelle, *The Marriage Penalty and Other Family Tax Issues*, Congressional Research Service, August 4, 1998, p. 35.

Addressing Marriage Penalties in the EITC

Increasing the standard deduction does nothing to relieve marriage penalties experienced by low- and moderate-income families that arise from the EITC phase-out. Nor does allowing a two-earner deduction affect EITC marriage penalties. More specific strategies are required.

As discussed above, the EITC is structured so it phases out gradually for families with incomes in excess of a specific level. In 1998, the phase-out range begins at $12,260 and continues through $26,473 for families with one child and $30,095 for families with two or more children. To the extent that the combined earnings of two people who marry boost the couple's income to a point in the phase-out that results in their receiving a smaller credit, or raises their income beyond the phase-out range, the family experiences a marriage penalty.

The proposals that address the marriage penalties resulting from the EITC phase-out do so through one of two general approaches.

- One approach is to modify the structure of the EITC so the phase-out begins (and ends) at a higher income level for married couples than for taxpayers who are not married.
- The other approach is to reduce, through a deduction that applies to the EITC computation, the amount of income that married couples must count for the purposes of calculating the EITC phase-out.

In either case, the effect is to increase, relative to current law, the amount of EITC a married couple can receive when its income falls in the phase-out range of the EITC schedule.

A bill introduced by Representatives Richard Neal and Jim McDermott (H.R. 3995) as a companion to the standard deduction increase for couples they have proposed takes the first approach and modifies the EITC structure. The Neal/McDermott bill would create a separate EITC computation for joint filers that increases the amount of income the couple can earn before the EITC begins phasing out. As noted, the phase out begins when income reaches $12,260 under current law; the Neal/McDermott approach would raise the beginning of the phase out for joint filers to nearly $17,000.

Raising the beginning of the phase out range means that married-couple families with incomes up to nearly $17,000 would be able to receive the maximum EITC. In addition, EITC-eligible married families with incomes above that level would receive somewhat larger EITCs than under current law, and the income level at which the EITC is fully phased out would increase.

The second approach was taken by Senator Phil Gramm (R-TX) in his amendment to the McCain tobacco legislation. The Gramm amendment would increase the standard deduction for married couples with incomes below $50,000. It included specific language to apply the additional deduction to the EITC computation.

The Gramm proposal effectively increases the income level at which the EITC phase-out begins by changing the definition of income for purposes of the EITC phase-out. Under current law, the income used to determine where in the phase-out range a family falls is the family's adjusted gross income or total earnings, whichever is larger. In the Gramm proposal, a married-couple family's adjusted gross income or earnings for EITC purposes would be reduced by the increase in the standard deduction.[8] The effect is substantively the same as the Neal/McDermott approach; couples in the phase-out range would receive somewhat larger EITCs for any given income level, and the income level at which the EITC is completely phased out for married couples would rise.

The Daschle proposal that was introduced in the Senate during the tobacco debate also follows the second approach of allowing a deduction to reduce the earnings or adjusted gross income counted for purposes of computing the EITC phase-out. In the Daschle approach, however, the deduction applies to the earnings of a second spouse. As a result, the change in the EITC phase-out would be more targeted, applying only to couples in which both spouses have earnings.

Costs and Possible Backloading

Marriage penalty reduction proposals are costly. The most costly proposals are those that not only reduce marriage penalties but also increase marriage bonuses and that provide tax reductions to couples regardless of income level. The proposals by Representative Bob Riley and Senator John Ashcroft for income splitting fall in this category, as does the proposal referred to as Weller II in this paper. When fully in effect, these proposals would cost $31 billion or $32 billion each year.

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[8] Specifically, the language says, "Section 329(c)(2) of the Internal Revenue Code of 1986 (defining earned income) is amended by adding at the end the following new subparagraph: '(C) Marriage Penalty Reduction.—Solely for purposes of applying subsectin (a)(2)(B), earned income for any taxable year shall be reduced by an amount equal to the amount of the deduction allowed to the taxpayer for such taxable year under section 222 [the additional standard deduction for couples].'"

The next most costly types of proposals are those that eliminate or substantially reduce marriage penalties for many middle- and upper-income taxpayers but do not increase current-law marriage bonuses. The proposal called Weller I in this paper fits into this category. It would cost about $20 billion each year.

Restoring the two-earner deduction as it existed from 1982 through 1986 — a deduction of 10 percent of the lower-earner's earnings — would be a little less expensive because the amount of the relief is capped. This approach would cost approximately $9 billion a year (assuming it was not extended to EITC families).

Proposals that expand the standard deduction for married couples, such as the McDermott bills or the Gramm amendment both, reduce marriage penalties and increase marriage bonuses. These measures would cost between $6.5 billion and $9 billion a year.

Finally, the Daschle approach, which would provide a second-earner deduction for married couples with incomes below $60,000 (including for EITC families), would cost approximately $3 billion a year. The Daschle amendment is targeted with respect to income and is limited to two-earner families who experience marriage penalties. (See box on pages 11-12 for the description of specific proposals.)

If the House majority leadership seeks to enact a bill with tax reductions totaling $70 billion to $80 billion over five years, it might seem that the more expensive proposals such as Weller II — with costs exceeding $160 billion over five years — could not be considered. This , however, is not the case. It is likely that one of the more expensive marriage penalty reduction proposals will move forward, structured to phase in very gradually. This would make the costs seem to fit within the total tax cut number and probably leave room for other types of phased-in tax cuts, as well.

The marriage penalty reduction offered by Senators Phil Gramm and Pete Domenici as part of the tobacco legislation, a $3,300 increase in the standard deduction for married couples with the EITC changes explained above, provides an example of how this might happen. When the proposal was first released, a fact sheet its sponsors disseminated said it cost $45 billion over five years. This represented the cost when the proposal would be fully in effect. By the time the proposal was introduced as an actual amendment to the tobacco legislation, however, the cost was down to not much more than a quarter of the original cost — $11.8 billion instead of $45 billion in the first five years. The provisions of the proposal had not changed. The difference was a slow phase-in. In the first year, 25 percent of the additional deduction would be allowed. In the second through fourth years, 30 percent would be allowed. In the fifth year, 40 percent would be allowed. The proposal was not scheduled to be phased in fully until 2008, some 10 years after enactment.

Moreover, marriage penalty tax relief might be offered in conjunction with a capital gains tax cut. Capital gains tax cuts generally raise revenues in the first few years after enactment, because lower rates or other favorable provisions induce some people to sell assets they otherwise would have held. Once the initial surge of additional asset sales subsides, however, the revenue losses set in. If a tax package were enacted that includes both marriage penalty reductions and a capital gains tax cut, the increased revenue collected on the surge of asset sales would serve to mask the cost of the marriage penalty tax cut in the first few years. But once the initial period passed, the revenue losses from both provisions would be fully felt. As noted below, this would become particularly problematic in the years after the baby-boom generation begins to retire and federal budget deficits are expected to return.

Can a Tax Cut be Afforded?

In recent weeks, some Members of Congress have suggested that the sizeable surpluses recently projected by the Congressional Budget Office make it possible to cut taxes substantially. But except for the reserve building in the Social Security system, which is needed to help cover the large Social Security costs the nation will face when the baby-boom generation retires in large numbers, there will be no significant surpluses until 2006, according to CBO. Excluding Social Security, CBO projects that deficits will total $137 billion over the next five years and that the net surplus will equal just $31 billion over the next 10 years.

Even the on-budget surpluses that CBO projects will start in 2006 provide no assurance that lawmakers can safely cut taxes. Projections of surpluses are notoriously difficult to make accurately, as they depend on myriad assumptions about fluctuating economic conditions. This difficulty increases as projections are made further into the future. Moreover, the reliability of the new CBO projections for the years starting in 2006 is further complicated by CBO's inability to explain $45 billion in unexpected revenue the government collected this fiscal year. CBO assumes this additional $45 billion in revenue will be collected in future years as well. If that does not happen, there may be little in the way of significant surpluses in the non-Social Security budget at any time over the next 10 years.

CBO's projections thus indicate a significant degree of uncertainty about whether non-Social Security surpluses will emerge even in 2006. CBO cautions:

> [I]f CBO's economic projections prove to be just a little too optimistic, surpluses could be much lower than anticipated, while a recession similar to that of the early 1990s could even produce a deficit. Likewise,

surpluses could be lower than projected if the factors that produced the unexpected revenues in 1998 fade away quickly.[9]

If economic conditions deviate even slightly from CBO's assumptions, as could happen, for instance, if the Asian financial crisis has a somewhat larger-than-expected impact on the U.S. economy, non-Social Security surpluses might not materialize over the next 10 years.

Finally, there still is a long-term deficit problem. CBO's long-term budget forecasts continue to show that budget deficits will eventually return (perhaps around or soon after 2020) and ultimately climb to record levels. Locking in large permanent tax cuts now will accelerate the year in which deficits return and increase the magnitude of those deficits.

For these reasons, it would seem imprudent to enact permanent tax cuts now on the grounds that they will be paid for either by surpluses that are really Social Security reserves that the Social Security system will ultimately need or by surpluses in the non-Social Security budget that *might* appear in 2006.

Alternatively, a tax cut could be financed by enacting offsetting spending reductions. The $101 billion in tax cuts over five years in this year's House budget resolution would be financed by substantial reductions in both mandatory and discretionary spending. Nearly 85 percent of the $41 billion proposed reductions in mandatory program expenditures that have not already been enacted would come from programs targeted on low-income households. Yet, such programs make up less than one-quarter of all mandatory program expenditures.[10]

As noted above, some of the leading marriage penalty reduction proposals target approximately 80 percent of their benefits to families with incomes exceeding $50,000. If marriage penalty relief were paid for by the type of mandatory program expenditure reductions proposed in the House budget resolution, poor families — including the working poor — would be paying for tax relief principally for the highest-income one-third of families.

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9 CBO, *The Economic and Budget Outlook for Fiscal Years 1999-2008: A Preliminary Update,* July 16, 1998, p. 12.

10 See Robert Greenstein and Sam Elkin, *House Budget Contains Large Cuts in Low-Income Mandatory Program Not Included in Senate Budget,* Center on Budget and Policy Priorities, June 12, 1998. In addition to the mandatory cuts, the House budget resolution would make substantial cuts in nondefense discretionary programs. Under the resolution, nondefense discretionary expenditures in 2003 would be 19 percent lower than in fiscal year 1998, after adjusting for inflation.

Do Marriage Penalties Prevent Couples from Tying the Knot?

Advocates for large marriage penalty tax cuts say the cuts are necessary because couples often forego marriage in order to avoid paying marriage penalties. They contend that by reducing or eliminating marriage penalties, more couples would be able to afford to marry and the number of marriages would increase. Economic evidence suggests, however, that the additional number of couples that would wed if marriage penalties were reduced is small. Most couples marry for reasons entirely unrelated to their tax liability, and research has confirmed that providing small economic incentives to some couples would not significantly increase the total number that decide to wed.

Economists James Alm at University of Colorado and Leslie Whittington at Georgetown University have studied extensively the behavioral effects that marriage penalties and bonuses generate. In a *National Tax Journal* article, they compared forty years of data on the percentage of women between the ages of 15 and 44 who were married with a measure of the change in income taxes women could expect with marriage in each of those 40 years. (The researchers also controlled for other factors that could affect marriage rates.) They found that for every 20% reduction in the average marriage penalty faced by women, the percentage of women who are married would increase by 1%, a very small response. In other words, this study suggests that if taxes were changed to reduce marriage penalties by 20 percent, the proportion of women in this age range who are married might rise from the current (1996) 52.9 percent to 53.4 percent.

The research also suggests that there would be a high cost to increasing the proportion of women who are married through reducing tax-based marriage penalties. According to CBO, none of the large marriage penalty tax cut proposals currently being considered would eliminate more than 50% of marriage penalties in the tax code.[11] If legislation reduces as much as 50 percent of marriage penalties, this research suggests the percentage of women age 15 to 44 who are married might rise from 52.9 percent to 54.2 percent. If the cost of eliminating 50 percent of marriage penalties is $20 billion a year (similar to Weller I) or $200 billion over 10 years, the government would essentially spend $250,000 for each couple that married as a result. If the cost exceeds $30 billion a year or $300 billion over ten years, comparable to the cost of the Riley,

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[11] CBO did not evaluate a proposal comparable to Weller I, but its results for other proposals suggest this conclusion holds for Weller I as well. Another analysis, by the minority staff of the House Budget Committee, finds Weller I eliminates 31 percent of marriage penalties.

Ashcroft, or Weller II proposals, the cost per additional couple married would be $380,000.[12]

Other research has found that marriage penalties do not reduce the marriage rate at all. Under somewhat different assumptions, Georgia State University economists David Sjoquist and Mary Beth Walker found that the size of the marriage tax did not have an effect on the number of women marrying per year.[13]

Both of these research teams did agree, however, that marriage penalties may play a role in the timing of marriage. They concluded that when marriage penalties increased, couples were slightly more likely to delay their marriage from the last quarter of the current year to the first quarter of the next in order to avoid filing jointly in the current year. Paying $20 to $30 billion per year to speed up a handful of marriages, though, is clearly a poor public investment.

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12 Alm, James and Leslie Whittington, "Does the Income Tax Affect Marital Decisions?," *National Tax Journal*, December 1995. Alm and Whittington selected 15 to 44 year-old women as the relevant population for their study. The Census Bureau reported that in 1996, 52.9 percent of women between the ages of 15 and 44 were married (31.5 million of 59.6 million). If the percentage of women who were married increased by 2.5 percent as a result of reducing marriage penalties, 54.2 percent of women between these ages would be married (102.5 percent of 52.9 percent). This additional 1.3 percent of married women aged 15 to 44 would represent 788,000 new couples (1.3 percent of 59.6 million). This means the $200 billion tax cut over ten years would essentially spend $253,000 for every new couple.

13 Sjoquist, David and Mary Beth Walker, "The Marriage Tax and the Rate and Timing of Marriage," *National Tax Journal*, December 1995.

Appendix
Marriage Penalty Calculations for Table 5

Proposed Tax Parameters

	Current Law		Weller I	Weller II
	Single	Married filing jointly	Married separate option	Married filing jointly
Personal exemption	$2,700	$2,700	$2,700	$2,700
Standard deduction	$4,250	$7,100	$4,250	$8,500
	Tax rate brackets end at taxable income of:			
15% rate ends at	$25,350	$42,350	$25,350	$50,700
28% rate ends at	$61,400	$102,300	$61,400	$122,800
31% rate ends at	$128,100	$155,950	$128,100	$256,200
36% rate ends at	$278,450	$278,450	$278,450	$556,900

Tax Calculations

1. Married couple, each spouse earns $32,000 a year[1]

	Current Law	Weller I - separate option		Weller II
		spouse 1	spouse 2	
Income	$64,000	$32,000	$32,000	$64,000
personal exemptions	-$5,400	-$2,700	-$2,700	-$5,400
standard deduction	-$7,100	-$4,250	-$4,250	-$8,500
Taxable income	$51,500	$25,050	$25,050	$50,100
income taxed at 15%	$42,350	$25,050	$25,050	$50,100
tax at 15%	**$6,352.50**	**$3,757.50**	**$3,757.50**	**$7,515**
Income taxed at 28%	$9,150	$0	$0	$0
tax at 28%	**$2,562**	**$0**	**$0**	**$0**
Total Tax	**$8,914.50**	**$7,515**		**$7,515**
Marriage Penalty	**$1,400**	**$0**		**$0**

[1] In calculating marriage penalties and bonuses, the couple's liability under the Weller I separate option is considered to be the same as it would have been had the two individuals been single. Thus, in the first example, the couple's marriage penalty is ($8,915 - $7,515) = $1,400.

2. Married couple, one spouse earns $64,000 a year

	Current Law	Weller I - separate option		Weller II
		spouse 1	spouse 2	
Income	$64,000	$64,000	$0	$64,000
personal exemptions	-$5,400	-$2,700	-$2,700	-$5,400
standard deduction	-$7,100	-$4,250	-$4,250	-$8,500
Taxable income	$51,500	$57,050	$0	$50,100
income taxed at 15%	$42,350	$25,350	$0	$50,100
tax at 15%	**$6,352.50**	**$3,802.50**	**$0**	**$7,515**
Income taxed at 28%	$9,150	$31,700	$0	$0
tax at 28%	**$2,562**	**$8,876**	**$0**	**$0**
Total Tax	**$8,914.50**	**$12,678.50[2]**		**$7,515**
Marriage Bonus	**$3,764**	**$0**		**$5,164**

[2] Because the Weller I separate option gives this couple a higher total tax, the spouses would choose the joint filing option, paying $8,914.50 (and retaining a $3,764 marriage bonus).

3. Married couple, each spouse earns $150,000 a year

	Current Law	Weller I - separate option		Weller II
		spouse 1	spouse 2	
Income	$300,000	$150,000	$150,000	$300,000
personal exemptions[3]	-$510	-$255	-$255	-$510
itemized deductions[4]	-$23,218	-$11,609	-$11,609	-$23,218
Taxable income	$276,272	$138,136	$138,136	$276,272
income taxed at 15%	$42,350	$25,350	$25,350	$50,700
tax at 15%	**$6,352.50**	**$3,802.50**	**$3,802.50**	**$7,605**
Income taxed at 28%	$59,950	$36,050	$36,050	$72,100
tax at 28%	**$16,786**	**$10,094**	**$10,094**	**$20,188**
income taxed at 31%	$53,650	$66,700	$66,700	$133,400
tax at 31%	**$16,631.50**	**$20,677**	**$20,677**	**$41,354**
income taxed at 36%	$120,322	$10,036	$10,036	$20,072
tax at 36%	**$43,316**	**$3,613**	**$3,613**	**$7,226**
Total Tax	**$83,086**	**$76,373**		**$76,373**
Marriage Penalty	**$6,713**	**$0**		**$0**

[3] Under current law, personal exemptions are reduced by 2 percent for every $2,500 by which the income of a high-income tax filer exceeds a specified threshold level. For married taxpayers filing jointly in 1998, the threshold level is $186,800. Since the Weller I language does not specifically address this phase-out, this example assumes that these rules for joint returns still apply. The $5,400 in total exemptions consequently are reduced by $4,890, and the remainder is split between the spouses under the Weller I separate option (in accordance with the 50-50 earnings split).

[4] According to the IRS, the average tax return with between $100,000 and $200,000 income in 1996 claimed $23,218 in itemized deductions. Since the overwhelming majority (88 percent) of these returns were filed by married taxpayers, the couple is assumed to split the $23,218 evenly under the Weller I separate filing option.

4. Married couple, one spouse earns $300,000 a year

	Current Law	Weller I - separate option		Weller II
		spouse 1	spouse 2	
Income	$300,000	$300,000	$0	$300,000
personal exemptions	-$510	-$255	-$255	-$510
itemized deductions	-$23,218	-$23,218	-$0	-$23,218
Taxable income	$276,072	$276,527	$0	$276,272
income taxed at 15%	$42,350	$25,350	$0	$50,700
tax at 15%	**$6,352.50**	**$3,802.50**	**$0**	**$7,605**
Income taxed at 28%	$59,950	$36,050	$0	$72,100
tax at 28%	**$16,786**	**$10,094**	**$0**	**$20,188**
income taxed at 31%	$53,650	$66,700	$0	$133,400
tax at 31%	**$16,631.50**	**$20,677**	**$0**	**$41,354**
income taxed at 36%	$120,322	$148,427	$0	$20,072
tax at 36%	**$43,316**	**$53,434**	**$0**	**$7,226**
Total Tax	**$83,086**	**$88,007**[5]		**$76,373**
Marriage Bonus	**$4,921**	**$0**		**$11,634**

5 Because the Weller I separate option gives this couple a higher total tax, the spouses would choose the joint filing option, paying $83,086 (and retaining a $4,921 marriage bonus).