Mountain Plains Journal of Business and Technology

Volume 2 | Issue 1 Article 5

Date Published 2001

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AN INTERNATIONAL COMPARISON OF TAXATION OF MARRIED INDIVIDUALS: IS THE "MARRIAGE TAX" UNIQUE TO THE UNITED STATES?

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ABSTRACT

The "marriage penalty" or "marriage tax" is a topic of considerable current interest. The purposes of this paper are to provide an explanation and brief example of the "marriage tax," a brief history of how it become part of the US tax code, and a comparison of how marital status affects tax liability in three other English speaking countries (Canada, England, and Australia) with progressive income taxes similar to the US.

I. INTRODUCTION

In testimony before the House Ways and Means Committee on February 4, 1998, June O'Neill, then Director of the Congressional Budget Office (CBO) described the "marriage tax" as the result of a conflict between three principles of tax fairness: equal treatment of married couples with equal incomes, tax neutrality as to marital status, which means that change in a couple's marital status does not affect total tax liability, and progressive taxation of household income. In attaining the first and third principles (equal treatment for all married couples and progressive taxation), the current US tax code violates the principle of neutrality of marital status, resulting in tax penalties or tax benefits as the result of changes in marital status. The sources of this lack of neutrality are the use of joint rates for married couples regardless of their individual income status, and the use of deductions and exemptions that differ on a per capita basis from those available to single filers. In order to simplify the examples used below, only the standard deduction is used as an example of this second category. Other examples would exemptions and deductions based on income and eligibility standards for the Earned Income Tax Credit (EITC). Married couples also derive additional benefits from exempts and exclusions by being able to pool their expenditures in these areas, thus often being able to more fully utilize them.

The "marriage tax" or "marriage penalty" occurs whenever a married couple pays more income tax than they would pay if they remained single. The marriage tax arises when both partners in a marriage have significant amounts of income. In 1996, the CBO estimated that a little more than 40% of filers paid a "marriage tax" averaging $1,380 per return. As an example of a couple faced with the marriage tax, consider Dink and Buffie Yuppie, who both earn $40,000 per year. If they remained single, Dink and Buffie would each pay $5,772 in taxes, for a total tax liability of $11,544 (See figure 1). If they marry, their tax liability on a joint return will increase to $13,074, resulting in a "marriage tax" of $1,530. Two factors cause the "marriage tax" to arise in this situation. First, although the 15% tax bracket in schedule Y-1 (married filing jointly) is wider than in schedule X (single filers)($43,850 as opposed to $26,250), it is less than double the schedule X amount . By marrying, Dink and Buffie thus reduce the amount of their income that will be taxed at 15% as opposed to 28%. Second, because the married standard deduction ($7,350) is less than double the deduction for singles ($4,400), they will have more taxable income when they are married ($67,050) than when they are single ($32,800 X 2 = $65,600).

A "marriage benefit" results if joint tax liability decreases as the result of marriage (a negative "marriage tax"). The CBO estimates that a little more than 50% of joint filers received "marriage benefits" in 1996. As a general rule, this situation arises when there is a substantial difference in the incomes of the partners in a marriage. To illustrate the "marriage benefit", consider the situation described above, now assuming that Dink makes $80,000 and Buffie has no income prior to marriage. Tax on a joint return is still $13,074, but total tax paid before marriage is now $17,249, resulting in a marriage benefit of $4,175(See figure 2). By marrying, Dink's income (which previously was enough to reach a 31% marginal rate) is now taxed using the wider tax brackets available to joint filers. The Yuppies can also take advantage of the increased standard deduction and Buffie's previously unused personal exemption, resulting in a reduction of taxable income from $72,800 to 67,050.

As the above examples illustrate, the current system of progressive taxation based on multiple marital status rate schedules meets the test of tax equity for single individuals and married couples with the same incomes. It is not, however, tax neutral with respect to marital status, resulting in a marriage tax or benefit depending on a couple's individual income distribution. The next section discusses

II. BRIEF HISTORY OF THE "MARRIAGE TAX"

From its inception in1913 until 1948, US tax law was marriage neutral in most states. Individuals, including married couples, filed individual tax returns on their separate earnings. However, married couples in the seven community property states were allowed to include one-half of their joint earnings, regardless of which spouse earned the income. When income is taxed progressively, community property treatment almost always results in a marriage benefit. Of course, this also meant that married couples in non-community property states usually paid more federal income taxes than married couples in community property states. This situation thus violated both the fairness principles of neutrality of marital status and equal treatment of all married couples described above.

In a 1941effort to deal with the inequitable treatment of married couples, Congress considered taxing all married couples on their joint incomes using the same rates as those applied to single taxpayers. Because this proposal would have created a "marriage penalty" for all couples with multiple incomes, its opponents criticized it as an attack on marriage itself. As a result, it did not become law. During this same period, more state legislatures began moving to creating community property laws to help lower their resident's federal income taxes.

The next effort to restore equitable treatment for all married couples came in 1948 with the adoption of new joint return provisions. Married persons were allowed to combine their incomes and pay taxes equal to twice as much as a single person would pay on one-half of the income. Thus, for example, a married couple earning a total of $40,000 would pay the same tax as two single individuals earning $20,000 each. This treatment almost always resulted in a "marriage bonus".

The effect of the 1948 changes effectively conferred the advantage of community property treatment to all taxpayers, thus eliminating a major source of inequity for married couples. However, it created a major disadvantage for single persons, who were unable to enjoy the benefit of splitting their incomes. For example, a single individual earning $40,000 per year would pay substantially more tax than a married couple earning $40,000 per year, even though all of the couple's income was earned by one spouse.

In 1969, Congress attempted to more equitably treat the taxation of income for single and married individuals by creating the present system of multiple rate schedules for different groups of filers based on marital status. This approach represents a middle ground between the approaches considered and used earlier. As was demonstrated in our opening example, some married couples are penalized while other married couples benefit.

Although much has been written about this "marriage tax" since 1969, the situation has often been made worse by new provisions such as the earned income tax credit for lower income taxpayers which fail to be marriage neutral. In 1994, a Republican Congress included elimination of the "marriage tax" as part of its "Contract with America" but subsequent efforts to pass legislation have resulted in failure. The incoming Bush administration has promised action on this issue.

III. COMPARISON WITH OTHER COUNTRIES

One possible source of alternatives to the present US situation is an examination of the treatment of marital status in the tax codes of countries with similar progressive income tax systems. The United Kingdom, Canada, and Australia were selected as examples of areas with accounting and tax traditions similar to those in use here. All three of these countries have a similar treatment of marital status for tax purposes. The United States is unique with respect to its system of assigning different tax rates to members of different filing status (single and married filing jointly, for example). In Canada, the United Kingdom, and Australia married individuals file separate returns based on their individual incomes and use only one set of tax rates. The system is similar to the one used in the United States until 1948.

In Canada and Australia, married couples receive a limited benefit through a tax credit so long as one of the spouses has only a very small amount of earnings. In Canada, this $675 credit is called a "spousal amount." In Australia, this credit is $844 and is termed a "spouse rebate." The United Kingdom provides a $453 credit called a "married couple's allowance" to all married couples without regard to income level.

To illustrate the effect of marriage in these other three countries, the opening example is repeated by calculating the income tax on individuals earning $40,000 as in Figure 1. All amounts shown in these three examples have been converted to US dollars using the exchange rates as of December 31, 1999.

Figure 3 shows that the amount of Canadian federal tax on two single individuals earning $40,000 each would be $7,749 apiece. If these individuals married, the married couple would pay the same $15,498 in tax as before (no spousal amount would apply at these income levels). Thus, this system is marriage neutral. However, if the couple's income was earned by one wage earner, their taxes would be substantially higher, thus violating the principle of equal treatment for all married couples.

Figure 4 illustrates that the amount of Australia federal tax on the single individuals earning $40,000 would be $12,807. Similar to Canada, the Spouse Rebate is lost for a married couple when both spouses earn $40,000, making their total tax $25,614. Again, the system is marriage neutral, but does not provide equal treatment for all married couples with the same income.

Figure 5 shows that the amount of tax in the United Kingdom on a single individual earning $40,000 would be $8,890. If two of these individuals married, the married couple would receive a $453 "marriage benefit" due to its "married couple's allowance" regardless of their income levels, making their total tax $17,327. This system thus always produces a "marriage benefit" in the amount of the allowance. As in Canada and Australia, married couples with the same total income pay different amounts of tax depending on the distribution of individual incomes.

These three brief and simple examples demonstrate that couples in the United States are affected much more by a change in marital status than those in the other three countries. In our first two examples, the "marriage penalty" and "marriage benefit" resulting from the decision to marry ranged from minus $1,530 to plus $4,175, representing percentage changes of +14% to -25% in tax liability. The "marriage benefits" in the other three countries ranged from $453 to $844; representing tax reductions of 3% to 5% at most. None of the married couples in the other three countries paid a "marriage tax."

IV. CONCLUDING REMARKS

As suggested earlier, "flat tax" advocates are quick to demonstrate that any tax system that utilizes progressive tax rates will inherently create "inequities" among taxpayers, including married couples. Presumably, then, if a "flat tax" system is ever implemented, the "marriage tax" may be eliminated.

Short of such a major restructuring of the U.S. tax system, any attempts to completely eliminate penalties in the present multiple-rate system will increase the size of marriage bonuses for others. Certainly, Congress needs to consider ways of eliminating the inequities exhibited by the "marriage tax"/"marriage benefit" provisions of the United States tax code. However, a system that will equitable to all taxpayers will be difficult if not impossible to attain. The most probable outcome is a continuation of the series of modifications that have taken place in this area which in the end always result in inequity for some taxpayers. The systems used in Canada, Australia and the U.K. provide possible alternatives. Their adoption in the U.S. would represent a return to the pre-1948 system of individually taxing personal income. A major problem would be the community property treatment of personal income and the division of income from jointly held enterprises. This type of system also results in different tax amounts for couples with the same incomes, depending on how individual income is distributed.

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Figure 1			
Marriage Tax Calculation			
	Dink's Income:	$40,000	
	Buffie's Income:	$40,000	
	Tax if single:		Dink and Buffie-
	(each individual)		Tax if Married:
Gross Income:	$40,000	Gross Income:	$80,000
Standard Deduction	$4,400	Standard Deduction:	$7,350
Personal Exemption:	$2,800	Personal Exemptions:	$5,600
Taxable Income:	$32,800	Taxable Income:	$67,050
Tax (Schedule X):	$5,772	Tax (Schedule Y-1):	$13,074
Tax (Dink and Buffie):	$11,544		
	Marriage Penalty:	$1,530	

Figure 2			
Marriage Benefit Calculation			
	Dink's Income:	$80,000	
	Buffie's Income:	$0	
	Tax if single:		Dink and Buffie-
	(Dink's Income)		Tax if married:
Gross Income:	$80,000	Gross Income:	$80,000
Standard Deduction:	$4,400	Standard Deduction:	$7,350
Personal Exemption:	$2,800	Personal Exemptions:	$5,600
Taxable Income:	$72,800	Taxable Income:	$67,050
Tax (Schedule X):	$17,249	Tax (Schedule Y-1)	$13,074
Tax (Dink and Buffie):	$17,249		
(Buffie has no income)			
	Marriage Benefit:	$4,175	

Figure 3			
Canadian Tax Calculation			
	Tax if single:		
	(each individual)		
			Tax if married:
Gross Income:	$40,000	Gross Income:	$80,000
Initial Tax:	$8,551	Initial Tax:	$17,102
Basic Personal Amount:	$802	Basic Personal Amount:	$1,604
Total Tax:	$7,749	Spousal Amount*:	$0
Total Tax (Two Singles):	$25,614	Total Tax:	$25,614
	Marriage Benefit/Penalty:	$0	
*-Spousal Rebate is $844 for lower-income taxpayers			

Figure 4			
Australian Tax Calculation			
	Tax if single:		
	(each individual)		
			Tax if married:
Gross Income:	$40,000	Gross Income:	$80,000
Initial Tax:	$12,807	Initial Tax:	$25,614
Total Tax:	$12,807	Spousal Rebate*:	$0
Total Tax (Two Singles):	$15,498	Total Tax:	$15,498
	Marriage Benefit/Penalty:	$0	
*-Spousal Amount is $675 for lower-income taxpayers			

Figure 5			
United Kingdom Tax Calculation			
	Tax if single:		
	(each individual)		
			Tax if married:
Gross Income:	$40,000	Gross Income:	$80,000
Initial Tax:	$8,890	Initial Tax:	$17,780
Total Tax:	$8,890	Couple's Allowance:*	$453
Total Tax (Two Singles):	$17,780	Total Tax:	$17,327
	Marriage Benefit/Penalty:	$453	
*-The Married Couple's Allowance applies to all married couples regardless of income.			
It always results in a marriage benefit in the amount of the allowance.			