

## Fixing the Marriage Penalty in the EITC

David T. Ellwood and Isabel V. Sawhill<sup>1</sup>

This document offers a brief examination of the key policy issues surrounding the EITC and marriage penalties. The EITC is designed to support low income working families with children. It provides a subsidy (up to \$3,816 in 1999) for families with children and low earnings. Current research shows that the EITC has been successful in raising the income of such families, increasing rewards/incentives to work among many low skill workers, and in stimulating greater work effort by single parents.<sup>2</sup>

A less well understood feature of the EITC is its impacts on marriage incentives. The EITC can generate sizable marriage bonuses for some couples and marriage penalties for others precisely because it is targeted on low-income families with children. Those with no children or no earnings qualify for little or nothing. And because benefits are phased out as family income rises, those with children and high earnings also get little or nothing. Thus it creates marriage rewards for couples where a non-working mother is considering marriage to a working man without children. "Her" children and "his" earnings allow them to qualify for the EITC when neither would qualify otherwise. Conversely, when a single parent is already working and qualifying for the full EITC, marriage to another worker will usually result in an EITC penalty. "His" earnings leads "her" EITC to be reduced since family income has been pushed up enough that the family qualifies for less than she did alone.

### **How Big Are the EITC Marriage Penalties and Bonuses?**

The EITC does not exist in isolation. Many people who potentially qualify for the EITC also qualify for means tested benefits such as food stamps, Transitional Assistance to Needy Families (TANF--formerly AFDC), and housing benefits. Means tested benefits inevitably include a high marriage penalty because married couples usually have higher incomes and thus qualify for less "welfare." Moreover, as earnings rise families also begin to pay regular federal income taxes and to be affected by other provisions of the tax code beside the EITC.

In this paper, we look at the effects of the EITC in isolation from these other provisions on the assumption that most reform proposals are likely to focus on a single provision of the tax code. But we want to emphasize that the interactions of all these tax and spending programs are important and suggest the value of more comprehensive assessments such as those in Ellwood (forthcoming).

---

<sup>1</sup> Ellwood is the Lucius N. Littauer Professor of Political Economy, John F. Kennedy School of Government. Sawhill is Senior Fellow, The Brookings Institution. This work was sponsored jointly by the Children's Roundtable of the Brookings Institution and the Domestic Strategy Group of the Aspen Institute.

<sup>2</sup> See for example Eissa and Liebman (1996), Meyer and Rosenbaum (1999) and Ellwood (forthcoming)]. Eissa and Hoynes (1999) and Ellwood (forthcoming) also offer evidence that the EITC may have reduced work among some married mothers.

Table 1 below, adapted from Wheaton (1998), shows EITC marriage rewards and penalties and the total tax rewards and penalties (which include all tax provisions, but exclude other effects from welfare or other programs) for the 1999 tax year just ended.

**Table 1**  
**1999 EITC Only Marriage Rewards and Penalties**  
**and Total Tax Related Marriage Rewards and Penalties**  
**By Family Income and Share Earned By Woman**

Key: **EITC Only Rewards or Penalties (-)**  
 (Total Tax Rewards or Penalties)

Couple's Total Income	Percentage of Income Earned By Woman				
	0%	25%	50%	75%	100%
\$10,000	<b>3,798</b> (4,240)	<b>2,607</b> (2,674)	<b>1,469</b> (1,469)	<b>625</b> (625)	<b>0</b> (0)
\$20,000	<b>2,228</b> (4,171)	<b>228</b> (1,421)	<b>-1,606</b> (-1,163)	<b>-1,400</b> (-1,400)	<b>0</b> (0)
\$30,000	<b>122</b> (3,195)	<b>-2,878</b> (-930)	<b>-3,159</b> (-2,337)	<b>-1,789</b> (-2,091)	<b>0</b> (540)
\$40,000	<b>0</b> (4,009)	<b>-3,816</b> (-2,244)	<b>-2,228</b> (-2,156)	<b>-140</b> (-658)	<b>0</b> (540)
\$50,000	<b>0</b> (5,309)	<b>-3,808</b> (-1,999)	<b>-1,175</b> (-1,693)	<b>0</b> (-518)	<b>0</b> (651)

Notes:

Positive numbers indicate marriage reward, negative numbers are marriage penalties. Calculation of total tax rewards or penalties equals the change in total tax liabilities. Assumes \$2,000 in allowable child care expenses, that each persons income will remain unchanged if couple is unmarried, children will go with wife, all persons use standard deduction.

Thus a couple where the man earns \$10,000 and the woman has no earnings can gain nearly \$3,800 in EITC benefits by marrying. Marriage penalties can also be sizable. For example, in

the case of a couple where both people earn \$15,000 (so that the couple has a total of \$30,000 and the "wife" is earning 50% of it), marriage can lead to an EITC loss of \$3,159.<sup>3</sup>

### **Do Marriage Penalties and Rewards Have an Impact on Marriage Behavior?**

An obvious first question is whether more people face marriage rewards or penalties. Various studies suggest that more low-income couples face marriage penalties than bonuses.<sup>4</sup> One interesting and ironic twist has arisen recently. Marriage *rewards* in the tax system are greatest when a *non-working* parent (such as someone collecting welfare) marries another working adult. Marriage *penalties* are greatest when a *working* parent marries another working adult. Recent changes in welfare policy, expansions of the EITC, and the strong economy have all lead to dramatic jumps in the number of single mothers who are working. Thus we have moved large numbers of women from a situation where tax policy rewarded marriage to one in which tax policy penalizes it.

The more critical question, of course, is whether all these incentives really matter. There are only a few studies that have examined whether marriage of low income adults is influenced by these EITC tax incentives. Thus far few behavior effects have been found. Ellwood (forthcoming) finds no clear effects of either the rewards or penalties on marriage patterns though he sees some hints that marriage and living arrangements may be changing slightly. Dickert-Conlin (1999) finds modest and somewhat conflicting effects on divorce.

Despite this apparent lack of behavioral consequences, many people argue that as a matter of symbolism or simple fairness, the law ought to be changed. Also, effects that may not be apparent in the short-run could emerge over the longer run as the disincentives to marry become better known and begin to influence social norms in low-income communities.

### **What Features of the EITC Create Rewards and Penalties?**

To understand alternative strategies for reducing or removing the EITC marriage penalties, it is necessary to examine which features of the program create the rewards and penalties. Marriage bonuses and penalties arise because the EITC benefits are based on family--not individual--income. If persons were allowed or required to file separately, then the problem would be eliminated. However, one would also weaken the targeting of the program considerably as couples where one spouse had high earnings and the other had low earnings could still qualify for a full EITC.

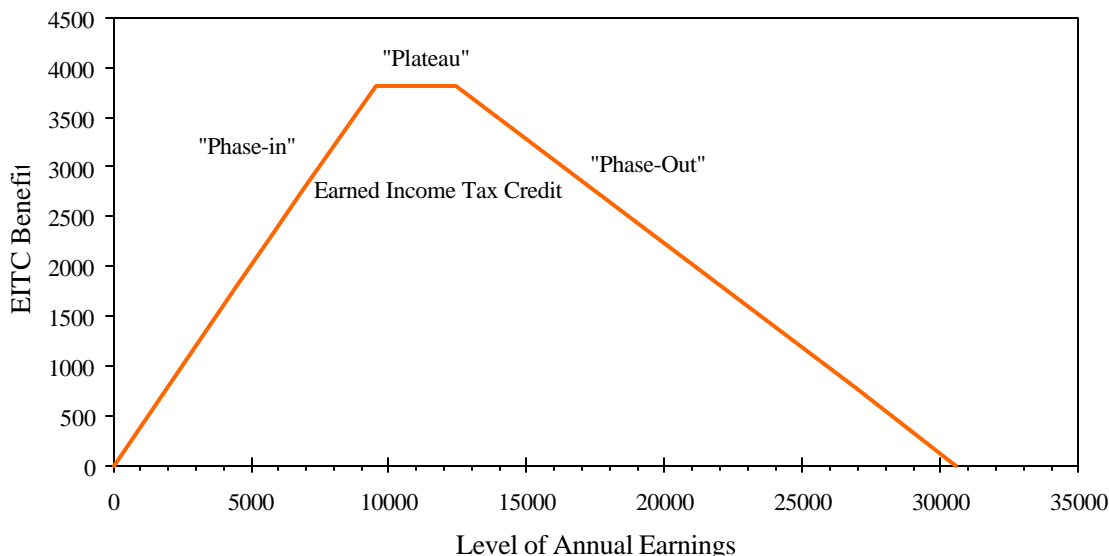
The EITC formula has three critical parts: the phase-in, the plateau, and the phase-out. The phase-in creates marriage rewards, the plateau creates an area of marriage neutrality, and the phase-out creates the marriage penalties. Each of the parts is illustrated on Figure 1.

---

<sup>3</sup> Other features of the tax code partially offset this penalty, but overall the couple still faces a penalty of \$2337--more than 7% of their income.

<sup>4</sup> See, for example, Ellwood (forthcoming).

Figure 1  
 Earned Income Tax Credit Payments in 1999 By Level of Earnings  
 For Family With Two Children  
 (Assuming No Other Income)



When a parent is alone, only her earnings count in figuring the EITC. When she marries combined income is used. Marriage thus tend to push people further up the family income scale used for determining EITC benefits. If marriage moves family income up along a portion where EITC benefits are rising with income--i.e. over the phase-in range, a marriage reward exists. If marriage moves income to another point along the plateau, there is no change in benefits. And if marriage pushes a couple up into the phase-out range, marriage leads to a loss of benefits.

### **How Can the Marriage Penalty in the EITC be Reduced and What are the Pros and Cons of Various Options?**

Strategies to reduce EITC marriage penalties tend to come in several broad categories: create a more integrated tax structure that removes the phase-outs and creates a "smoother tax system," allow separate filing or at least some form of income splitting, EITC plateau extension for married couples, and a slower phase out of the EITC. We will briefly consider five options.

#### **1. Option One: Integrate EITC and other Tax Elements Into a Smoother/Simplified Tax Structure**

Gene Steuerle has suggested that it might be possible to reduce marginal tax rates to 30-40 percent among low-income families by creating a much more integrated benefit and tax system, by making tax credits more universal or by extending them up the income scale. Ellwood and Liebman (2000) point out that the current tax system offers sizable benefits to low income parents via the EITC and to moderate to high income parents through the value of deductions, exemptions, and various non-refundable credits, but often provides the least support for low to moderate income families. They examine a variety of options for replacing several refundable and non-refundable tax benefits

associated with children including a single refundable child tax credit benefit which might be phased in with income just as the EITC is. If the phase out of EITC/Child benefits was reduced or eliminated, so too would marriage penalties.

Pros:

- Comprehensive plans could produce a far more rational and coordinated system and one that gave as much attention to disincentives at the bottom of the income scale as at the top.
- More modest plans might offer a way of effectively providing a tax cut to middle class families with children while removing or reducing tax based marriage penalties and work disincentives.

Cons:

- Likely to be very expensive.
- Difficult to enact because of the complex politics involved in eliminating and redesigning tax and transfer systems.

2. **Option Two: Allow Married Couples To File Separately**

If married couples were allowed to file separately (a system common in Europe), tax liability would depend solely on one's own income or earnings. Thus, marriage could in no way affect taxes owed (although rules would be needed to prevent couples from shifting asset ownership for tax purposes). Individual filing can be mandatory or voluntary. In a voluntary system, taxpayers would have the option of filing separately or as a married couple. Mandatory separate filing is much less costly because it would also eliminate marriage bonuses and this new tax revenue could be used to help pay for the elimination of marriage penalties.

Pros:

- Completely eliminates all marriage penalties.
- Easy to understand and arguably more appropriate in a world where most adults are working and thus have their own income.

Cons:

- Mandatory individual filing not likely to be politically feasible in the U.S. since it would create a large number of tax losers.
- Voluntary individual filing is very expensive.
- Could lead to sizable EITC benefits going to high income families with one highly paid worker and another working part-time or earning modest amounts at personally rewarding low-paid work.

3. **Option Three: Allow Married Couples to Split Their Income For EITC Purposes**

Some sizable marriage penalties occur when a woman with two children and modest earnings marries a man who earns considerably more. In Table 1 above, for example, a mother earning \$10,000 who marries a man making \$30,000 (becoming a \$40,000 couple with the wife earning 25%) would lose \$3,816 in EITC benefits. Under this proposal,

they would be permitted to split their earnings in calculating their EITC benefits--getting the same benefits as a couple with \$20,000. As a result they would lose only \$1,600 in EITC benefits. Thus this proposal is equivalent to doubling the maximum income a married couple can have before the EITC phases out and halving the phase down rate.

Pros:

- Treats marriage as a partnership in which two people share earnings and responsibility for children.
- Significantly reduces marriage penalties.
- Provides more targeted support than voluntary individual filing.

Cons:

- Relatively expensive to implement.
- Provides EITC benefits to much higher earning couples than under present law (families with earnings of upwards of \$50,000 could still qualify).
- Increases marriage rewards as well as reducing marriage penalties.
- Adds some complexity to the tax code. Less easy to understand than some other plans.

#### **4. Option Four: Create an EITC Earnings Deduction/Extend the Plateau for Married Couples**

Extending the plateau for married couples, while leaving it unchanged for single parents can reduce marriage penalties. Doing so has two effects. First it extends the range of the EITC where marriage is neutral. Second it pushes EITC reductions out to higher levels of income where the EITC reductions can be partially offset by the non-refundable tax credits that only have value when families owe regular taxes.

Operationally this reform can be achieved by changing the EITC parameters for married couples or by allowing married couples to take an additional deduction from their income before calculating their EITC phase-out. One could require that the deduction be limited to the amount of earnings received by the lower-earning spouse.

For example, some plans suggest that couples be allowed to apply the standard deduction (currently \$7200 for a married couple) to their income for purposes of calculating the EITC phase-out. This is equivalent to extending the end of the plateau from \$12,500 up to \$19,700. This would entirely eliminate the marriage penalty for any couple with combined income of \$20,000 or less, and it would reduce it by \$1,500 for couples earning \$30,000.

Pros:

- Relatively simple change in the law.
- Less expensive than other options.
- If limited just to two-earner couples, well targeted at low income couples who face the largest marriage penalties.
- Can be justified on the basis that working couples have more expenses and less leisure time than one-earner couples with the same income.

Cons:

- If limited to two-earner couples, arguably violates the principle that two families with same income should pay the same taxes.
- A \$7,200 deduction would have no impact on marriage penalties for those with incomes above \$40,000.
- Adds further complexity to the tax code, especially if limited to two-earner couples.

## 5. **Option Five: Reduce the Phase-Out Rate for Married Couples**

Under this plan, the current phase out rate of 21.06% for married couples with two children would be reduced to perhaps 15% or even 10%. This means that the additional income of a spouse will reduce the EITC less quickly and couples will qualify for the EITC up to a considerably higher level of income. Interestingly, such a plan seems to particularly benefit couples at the higher end of the EITC income scale. For example, reducing the phase out rate to 15% would provide a couple earning \$10,000 each (\$20,000 combined income) with a \$500 marriage penalty reduction and a couple where each earns \$15,000, (\$30,000 combined income) a reduction of roughly \$1,000. If one lowers the phase-out rate to 10% the reductions rise to \$800 and \$1,900 respectively. At this 10% phase-out rate, couples with incomes as high as \$50,000 still would qualify.

Pros:

- Very easy to implement.
- Less expensive than first three options, (but probably more costly than option four).
- Maintains principle that all couples with same income are treated identically.

Cons:

- Marriage penalty reductions targeted on upper end of EITC income range. Provides only modest relief for couples at \$20,000 and below.
- Provides EITC payments to much higher income families than under current law.
- Increases marriage rewards for some families with one relatively high earner.

## **Comparing the Options**

Table 2 displays marriage penalties and rewards under several of these options. For example, if a woman earning \$10,000 marries a man who also earns \$10,000, under current law they pay a penalty of \$1,606; under the income splitting proposal, they would receive a bonus of \$3,281; and under a \$7,200 low-earner deduction, they would still pay a penalty but it would be much smaller (\$90).

**Table 2**  
**1999 EITC Marriage Rewards and Penalties**  
**Under Alternative Options**

Couple's Total Income	Option	Percentage of Income Earned By Woman				
		0%	25%	50%	75%	100%
\$10,000	<b>Current Law</b>	<b>3,798</b>	<b>2,607</b>	<b>1,469</b>	<b>625</b>	<b>0</b>
	3: Doubling method	3,982	2,791	1,653	809	184
	4a: \$7200 married deduction	3,798	2,607	1,469	625	0
	4b: \$7200 low earner deduction	3,798	2,607	1,469	625	0
	5a: 15% phase out rate	3,798	2,607	1,469	625	0
	5b: 10% phase out rate	3,798	2,607	1,469	625	0
\$20,000	<b>Current Law</b>	<b>2,228</b>	<b>228</b>	<b>-1,606</b>	<b>-1,400</b>	<b>0</b>
	3: Doubling method	6,562	3,562	3,281	4,651	6,440
	4a: \$7200 married deduction	3,744	1,744	-90	116	1,516
	4b: \$7200 low earner deduction	2,228	1,281	-90	-347	0
	5a: 15% phase out rate	2,685	685	-1,149	-1,097	0
	5b: 10% phase out rate	3,062	1,062	-772	-847	0
\$30,000	<b>Current Law</b>	<b>122</b>	<b>-2,878</b>	<b>-3,159</b>	<b>-1,789</b>	<b>0</b>
	3: Doubling method	6,562	3,562	3,281	4,651	6,440
	4a: \$7200 married deduction	1,638	-1,362	-1,643	-272	1,516
	4b: \$7200 low earner deduction	122	-1,362	-1,643	-272	0
	5a: 15% phase out rate	1,185	-1,815	-2,250	-1,334	0
	5b: 10% phase out rate	2,062	-938	-1,500	-959	0
\$40,000	<b>Current Law</b>	<b>0</b>	<b>-3,816</b>	<b>-2,228</b>	<b>-140</b>	<b>0</b>
	3: Doubling method	4,456	640	2,228	4,316	4,456
	4a: \$7200 married deduction	0	-3,816	-2,228	-140	0
	4b: \$7200 low earner deduction	0	-3,816	-2,228	-140	0
	5a: 15% phase out rate	0	-3,816	-2,685	-1,203	0
	5b: 10% phase out rate	1,062	-2,754	-2,000	-1,018	0
\$50,000	<b>Current Law</b>	<b>0</b>	<b>-3,808</b>	<b>-1,175</b>	<b>0</b>	<b>0</b>
	3: Doubling method	2,350	-1,457	1,175	2,350	2,350
	4a: \$7200 married deduction	0	-3,808	-1,175	0	0
	4b: \$7200 low earner deduction	0	-3,808	-1,175	0	0
	5a: 15% phase out rate	0	-3,810	-1,935	-60	0
	5b: 10% phase out rate	62	-3,750	-2,500	-1,250	0

Notes: See Table 1

**Does One Option Seem to Dominate?**

The answer, of course, depends on one's objectives. Still we were somewhat surprised to discover that option four--the plateau extension/married earnings deduction--seems to be relatively well targeted at the group suffering marriage penalties, provides few new rewards to



those already getting them, and therefore is almost certainly the least expensive way to reduce marriage penalties in the EITC. If other goals, such as middle class tax relief or expansion of the EITC to higher income married families is a goal, then other options may be more attractive.

References:

- Dickert-Conlin, Stacy.** "Taxes and Transfers: Their Effect on the Decision to End a Marriage." *Journal of Public Economics*. 73 No. 2 (August 1999): 217-40.
- Eissa, Nada, and Hilary Hoynes.** "The Earned Income Tax Credit and the Labor Supply of Married Couples." University of California at Berkeley, Mimeo, 1999.
- Eissa, Nada, and Jeffrey B. Liebman.** "Labor Supply Response to the Earned Income Tax Credit." *Quarterly Journal of Economics*. 112 No. 2 (May 1996): 605-637.
- Ellwood, David T.** "The Impact of the Earned Income Tax Credit and Social Policy Reforms On Work, Marriage, and Living Arrangements." *National Tax Journal*. (forthcoming).
- Ellwood, David T., and Jeffrey B. Liebman.** "The Middle Class Parent Penalty: Child Benefits in the U.S. Tax Code." Harvard University, Mimeo, 2000.
- Meyer, Bruce, and Daniel Rosenbaum.** "Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers." Northwestern University, Mimeo, 1999.
- Wheaton, Laura.** "Low-Income Families and the Marriage Tax." The Urban Institute. 1998. [http://www.urban.org/family/marriage\\_tax.html](http://www.urban.org/family/marriage_tax.html). Accessed February 23, 2000.