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MANIPULATING MARRIAGE? FEDERAL INCOME TAXES AND THE HOUSEHOLD STRUCTURE DECISION

Leslie Whittington

The topic of her remarks is: "Manipulating Marriage, Federal Income Taxes and the Household Structure Decision."

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Professor Leslie Whittington

PROF. WHITTINGTON: Thank you very much, Ann.

Marriage is, clearly, a social institution but it is a social institution that is shaped, undoubtedly, by some financial factors. One such factor that likely plays a role in the marriage decision and in the divorce decision is the federal individual income tax.

Economists posit that individuals or couples would decide to marry if, somehow, the benefits of marriage were perceived as outweighing the costs of marriage.[6] Taxes enter this marriage calculus in the United States because the individual income tax is not, as Professor O'Neill pointed out, marriage neutral. This means that one's tax burden may change simply as a function of marriage. In other words, two people may pay more in taxes as a married couple then they would combined as two individuals. If that is the case, they incur a marriage penalty or a marriage tax.[7] However, it is also true, as Professor O'Neill pointed out, that a substantial number of people may incur a smaller tax burden as a married couple then they would as two combined individuals. Those couples receive a marriage bonus, or a marriage subsidy.[8]

Theoretically, this non-neutrality in the tax treatment of marriage should influence marriage and divorce decisions. The non-neutrality affects individuals or couples in two ways. First, there may be a difference in the total tax burden that couples incur. Second,

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Decisions].

[6] *See Marital Decisions, supra* note 5, at 565-66 (illustrating the manner in which the tax code affects decisions of marriage and divorce).

[7] *See* U.S. GENERAL ACCT. OFFICE, 1996 ANN. TAX REP. 22 (1997).

[8] *See id.*

there may be a difference in the marginal tax rate. That is the tax rate paid on the last dollar earned for either or both individuals in the marriage.

A substantial body of work focuses on the latter issue, the impact of the marginal tax rate changes that individuals incur as a result of marriage.[9] Most of that work is focused on the labor supply and labor force participation decisions, particularly of the wife, given her historical status as the so-called "secondary earner." This body of work has found that, in general, because the return to work tends to fall as the marginal tax rate increases, the secondary earner has less of an incentive to work. Consequently, the labor supply tends to be reduced as a function of the increased marginal tax rate generated by the marriage.[10]

The focus of my work, joint with my co-author Jim Alm, is, instead, on a different efficiency issue. That is, whether this change in the marginal tax rate or the change in the total tax burden of the individuals in marriage has influenced marriage behavior. The idea that it has influenced marriage behavior is certainly not novel; we do not pretend to offer a theoretical contribution in that respect. However, until our research work, no one had really focused on whether or not, what in theory clearly exists — a disincentive for marriage in some cases and an incentive for marriage in other cases — is noted empirically to influence marriage.

Rather than making you wait until the end of my ten-minute comments, I will tell you that, yes, in fact, we find that taxes do influence marriage and divorce decisions. We find that the marriage tax has a negative impact on marriage probabilities, meaning the larger the tax burden the less likely the probability of marriage. We find that the marriage tax has a positive impact on the probability of divorce, meaning the higher the marriage tax, the higher the probability of divorce. And we find that the marriage tax has a positive impact on the probability of delaying marriage from one year

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[9] *See, e.g.*, Lawrence Zelenak, *Marriage and the Income Tax*, 67 S. CAL. L. REV. 339 (1994) (discussing the impact of marriage on an individual's tax rate).

[10] *See* Laura Ann Davis, Note, *A Feminist Justification for the Adoption of an Individual Filing System*, 62 S. CAL. L. REV. 197, 198 (1988) (discussing the disincentives that a secondary earner may face when deciding whether to enter the job market).

to the next, presumably, in order to avoid, for that last year, the marriage tax. However, we find that, in all cases, this effect is relatively small; and that it does differ between men and women. This difference is most likely due to their different states as primary or secondary earners.

Let me give you a little bit more on each of those findings. First, with respect to marriage, we find that the marriage penalty — that is the change in the total tax burden that is borne by people as married couples rather than as individuals — has a more statistically significant impact for women.[11] The elasticity, or the responsiveness, is relatively small. On average, we would find that a ten-percent decrease, say, in the marriage tax would increase the marriage probability by about two-percent or less. However, in looking at this decision, we find that when we treat men and women separately, the tax penalty has little effect on men's marriage decisions. Again, this is probably related to our modeling of them as primary or secondary earners. We also find that the marginal tax rate has a non-trivial effect on women and an effect on men that is small, but certainly significant. So marriage appears, both in the aggregate and in the microeconomic or household data, to in fact be affected by taxes.

We find similar results with respect to divorce. Women tend to be impacted at a greater rate and seem to be more responsive to changes in their tax burden than men.[12] In fact, the responsiveness, with respect to taxes and divorce, is even greater than that with respect to marriage, which makes some sense.[13] I suppose that once you are in the institution, you have a little clearer idea of what your tax burden is going to be. The taxes may be just the last straw that really pushes you over the edge toward divorce, but we do find people to be more responsive than in the marriage decision.

With respect to timing a marriage, we look at whether couples get married in the last quarter of a year versus postponing to the first

[11] *See id.* at 198 (discussing the adverse effects of the marriage penalty on women). A husband has historically controlled a couple's assets. Nonetheless, the current tax code offers no incentive for a husband to transfer income to his wife. *Id.*

[12] *See* Zelenak, *supra* note 9, at 359 (stating that divorces, like marriages, can likewise be motivated by tax considerations).

[13] *See id.* at 364 (discussing the incentive created by the marriage penalty for taxpayers to divorce or remain unmarried).

quarter of the next year, controlling for what few other things could change over that period of time. We find that couples are significantly more likely to delay marriage to the next quarter if they are going to incur a large marriage penalty. They are also more likely to pull marriage into the current tax year if they are going to incur a large marriage subsidy. In fact, when we try and put numbers as to how many couples may have done this, we find that in the mid 1980s, out of about 2 1/2 million marriages, between 50,000 and 150,000 marriages may have been affected, with regard to timing, by the marriage tax.[14]

So what is the bottom line? The bottom line is that taxes do affect marriage behavior. Thus, if we eliminate marriage penalties we can change marital behavior.

However, I would like to point out four facts that I want you to consider in weighing our options today. Because it is not quite so simple to legislate out the marriage tax.

First of all, of course, the marriage tax is not a statutory item. We do not have in our Tax Codes something that says there will be a marriage tax or a marriage penalty, or there will be a marriage subsidy. The non-neutrality was largely accidental and not the result of some intended manipulation of marriage.[15] It arose because of the two other features in the tax system that, to date, we have considered to be, apparently, of more importance than marriage neutrality. The first is progressivity in the tax system and the second is horizontal equity — similar treatment of individuals or families at similar levels of income in similar situations. It is well recognized that you cannot have both features and marriage neutrality at the same time. As such it is, in fact, a societal issue or, a legislative decision about which of those tax features we want. If we want marriage neutrality, we have to forego one of the others. Although in the past the stated reasons for the design in tax policy have not been to manipulate marriage, the current proposals are frequently aimed at encouraging marriage or, at

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[14] *See generally Marital Decisions*, *supra* note 5 (discussing the probability that a couple may schedule marriage during certain times of the year for tax reasons).

[15] *See* Dorothy A. Brown, *The Marriage Bonus/Penalty in Black and White*, 65 U. CONN. L. REV. 787, 788 (explaining that the Internal Revenue Code exhibits latent structural inequities in its treatment of married taxpayers).

least, not discouraging it. Therefore, the current proposals often are aimed at manipulating marriage, one way or the other.

The second point that I would like to underscore is a point noted by Dr. O'Neill; that is, there are a substantial number of couples that receive a marriage subsidy.[16] Not everyone is a loser in the tax system. It is precisely those couples who are most traditional, those who have a single breadwinner, that are the most heavily subsidized.

Note that most of the current proposals for change do not suggest that we move towards marriage neutrality, rather, what most of them suggest is that we maintain the subsidies and do away with the penalties.[17] However, if we have some more fundamental changes in the tax system, like discarding progressivity in favor of a proportional tax or moving to the individual as the unit of taxation, there will be a substantial number of couples who will pay more in taxes as a result of the change.[18] That means that, although it seems bizarre, we could change the tax system in order not to discourage marriage and end up with fewer couples marrying. If the subsidies that we take away outweigh the penalties that are built in, doing away with both could end up with a net change of zero in marriage behavior or even a decrease in marriage or an increase in divorce. That would depend on how many couples were affected and their relative responsiveness.

Third, it is important to realize that any change requires a trade off, as I said before. Therefore, if we move to the adoption of marriage neutrality because we think that is a societal goal now, then we have to recognize that we forgo progressivity or horizontal equity.

Finally, I think, it is very important to realize that some of the most severe penalties that are inherent in the tax system — severe in

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[16] *See* Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 UCLA L. REV. 983, 992 (1993) (stating that the Internal Revenue Code favors single-earner married couples over "equal-earning" married couples).

[17] *See* H.R. 1215, 104th Cong. (1995); *but see* Davis, *supra* note 10, at 218 (explaining the view that the Internal Revenue Code should ignore marital status altogether).

[18] *See* Zelenak, *supra* note 9, at 342 (explaining the view that progressivity is a desirable facet of the current tax system); *cf.* Brown, *supra* note 15, at 798 (advocating the abolishment of the marriage penalty and bonus in order to make the individual the sole unit of taxation).

terms of their proportion of income relative to an individual's income — are those that are inherent in Earned Income Tax Credit (EITC). Frankly, I don't have anywhere nearly as much sympathy for high-income, dual-earner couples who incur a marriage penalty, which is relatively small relative to their income, as I do for low-income, two-earner couples who incur enormous tax penalties because of the loss of the EITC. I want you to look at the current proposals and realize how few of those proposals address the marriage penalty that is so severe in the EITC.[19] I believe it is the marriage penalty that we ought to be focusing on because it represents the most difficult problems for us in terms of resolving it and maintaining equitable taxation.

Thank you.

PROF. THOMAS: Thank you, Leslie. We will hold questions until all the panelist have had their say. Amy Ellen Schwartz is our next panelist. She is also an economist and she is Associate Professor at New York University's Wagner School of Public Service. Professor Schwartz has asked a question, and hopefully she will answer it, that goes to the question of the theory of taxation of married couples that underlies present law. The behavioral effects that Professor Whittington has just been speaking about are a result of the current joint return. Professor Schwartz's question this morning is "Whose money is it?" This is a vital issue in the assessment of the fairness of the joint return and the alternatives to it that we will hear more about later this morning.

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[19] *But see* Ann L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533 (1995) (arguing that overemphasizing speculation as to whether the E.I.T.C. discourages work and marriage oversimplifies the debate). *See generally* Dorothy A. Brown, *Race, Class, and Gender Essentialism in Tax Literature: The Joint Return*, 54 WASH. & LEE L. REV. 1469, 1479-81 (1997) (explaining the mechanics of the EITC marriage penalty).