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Marriage Penalty: How Stacking Income Affects the Secondary Earner’s Decision to Work

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I. Overview

Our progressive tax rate structure is aimed at taxing citizens fairly and based on their ability to pay.\textsuperscript{1} The rate structure, however, partially loses its purpose when analyzing the income taxation of married individuals.\textsuperscript{2} If a married couple decides to file jointly they are sometimes taxed at higher rates than individuals are depending on the incomes of the couple.\textsuperscript{3} This has created what we know today as the “marriage penalty,” and it can serve as a deterrent to the secondary earner from working. There is no simple solution to address how the marriage penalty, in combination with necessary expenses, affects the secondary earner’s decision to work. This is why legislators and scholars have introduced a variety of policies to help remedy the issue. The policies currently in place, however, are not sufficient to resolve the issues surrounding the secondary earner’s decision to work.

This paper will first describe the mechanics of how the marriage penalty and stacking of income affects the secondary earner’s decision to work. The paper will then turn to address some of the solutions that have been proposed to help remedy the issue and why these proposals are not viable solutions. Next, a new solution will be introduced and detailed. Lastly, although all of the proposals attempt to resolve the issue of how the marriage penalty affects the secondary earner’s decision to work, they do not address childcare expenses, which is a major factor that a secondary earner takes into consideration when deciding whether to work or stay at home and take advantage of imputed benefits. The paper will briefly discuss two options that are available

\textsuperscript{1} 26 U.S.C. § 1 (2012).
\textsuperscript{2} \textit{Id.}
\textsuperscript{3} \textit{Id.}
to help offset childcare expenses and how these options can be improved to further eliminate the disincentive for the secondary earner to work.

II. The Marriage Penalty and Stacking Income’s Affect on Secondary Earners

When a couple marries and decides to file jointly their incomes are essentially pooled together. This “pooling” of income has multiple effects. First, for some couples, there is a marriage penalty, because instead of each person taking advantage of the low-rate progressive structure the couple’s income is taxed at higher rates sooner than single filers with the same income. Still, other couples may face a marriage bonus because of the more generous tax brackets facing married individuals. Second, there is a strong bias in favor of single-earner families as a result of pooling spousal income, stacking the secondary earner’s income on top of the primary earner’s income and the accompanying tax rate structure. The focus of this paper will describe how the stacking of the secondary earner’s income on top of the primary earner’s income may affect the secondary earner’s decision to work. The solutions described in detail below are proposed to address this issue.

When the couple’s incomes are pooled together, the spouse that makes the least, termed the “secondary earner,” is deemed to have his or her income “stacked” on top of the spouse that makes the most, termed the “primary earner.” This secondary earner is deemed to be the “marginal earner” because the secondary earner’s income is stacked on top of the primary earner’s income and the secondary earner’s income is taxed at the primary earner’s marginal

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6 McCaffery, supra note 4, at 989; McCaffery, supra note 4, at 1025-26.
rate.\textsuperscript{8} Therefore, each dollar that the secondary earner makes is taxed at the primary earner’s marginal rate.\textsuperscript{9} The issue that arises is whether the secondary earner will choose to work upon consideration of what the take-home pay will be following taxes and expenses.

Assuming that the primary earner makes enough income to put the couple in the highest tax bracket, all of the income the secondary earner makes will be taxed by the federal government at a 39.6\% rate.\textsuperscript{10} Adding in other payroll taxes such as Social Security, Medicare and state & local taxes, the secondary earner can be subject to more than 50\% of taxes on the income.\textsuperscript{11} The consideration of whether to work also includes expenses associated with working. These expenses include clothing, travel, training, and most importantly, childcare.\textsuperscript{12} Using New York City as a benchmark, “[i]n Brooklyn, day care costs can cost $1,700 per month, while it can run as much as $2,300 a month in Manhattan.”\textsuperscript{13} The secondary earner may not bring in much income to the household after taxes from earned wage income and necessary costs of working are taken into account. In fact, it may actually cost the secondary earner money to work considering the very high childcare expenses in New York City.

In deciding whether to work, the secondary earner will balance the small gain from working against leisure time, the imputed income of working as a homemaker/taking care of children and also spending more time with the family.\textsuperscript{14} Thus, the secondary earner may choose not to work and the primary earner may work more to make up the difference in income.\textsuperscript{15} Financially, this may make the most sense. This demonstrates that the Internal Revenue Code is

\textsuperscript{9} McCaffery, supra note 4, at 989.
\textsuperscript{10} 26 U.S.C. § 1 (a) (2012).
\textsuperscript{11} McCaffery, supra note 4, at 989.
\textsuperscript{12} Zelenak, supra note 8, at 351.
\textsuperscript{13} McCaffery, supra note 4, at 1008-1009; Loans for day care issued to New York City parents, CNN Money, http://money.cnn.com/2013/08/05/news/economy/day-care-loans/ (August 5, 2013).
\textsuperscript{14} McCaffery, supra note 4, at 1026-1028.
\textsuperscript{15} Id.
working inefficiently because it is changing individuals’ behavior—secondary earners deciding not to work as a result, at least partly, of tax implications.

III. Inefficiency, Elasticity and Critiqued Proposals

The Internal Revenue Code is not operating efficiently with respect to secondary earners because secondary earners are changing their behavior as a result of tax consequences. Also, the Code is not operating fairly because secondary earners are taxed at the primary earner’s marginal rate for the first dollar earned.16 In a similar light, secondary earners can be viewed to have a highly elastic labor supply curve because taxes play a large role in the secondary earner’s decision to work.17 Essentially, the higher the tax rate applied to the secondary earner’s wage income the less likely the secondary earner will choose to work versus staying home and taking advantage of imputed income benefits.18 For this group of workers, the substitution effect is greater than the income effect.19 Moreover, a labor supply deadweight loss is created when the substitution effect results in the secondary earner choosing to stay at home in favor of working.20

The primary earner’s income, on the other hand, is more inelastic because the tax rate plays less of a role in the decision of the primary earner to work.21 In other words, regardless of the tax rate, the primary earner is going to work. In contrast to the secondary earner, a higher tax rate may impose an income effect on the primary earner to work harder to make up the difference in income.22

16 Zelenak, supra note 8, at 365-366.
17 Id. at 1037-1039.
18 McCaffery, supra note 4, at 1028; McCaffery, supra note 4, at 1037-1040.
19 McCaffery, supra note 4, at 1028; McCaffery, supra note 4, at 1037-1040.
21 McCaffery, supra note 4, at 1037-1039.
22 Id.
Some scholars have proposed an optimal tax to address the elasticity differential between the primary and secondary earner and the corresponding substitution/income effects. The optimal tax proposes that secondary earners should be taxed less and primary earners taxed more. Scholars reason that because primary earners are more inelastic to changes in wage tax rates the increase in taxes will not affect their decision to work. Additionally, optimal tax proponents argue that because secondary earners are highly elastic to wage rates, the wage rates for secondary earners should be lowered. A justification for the optimal tax is that tampering with the tax system in this way can provide neutrality amongst spousal income earners.

This proposal, however, treats primary earners and single filers unfairly. Primary earners would be treated unfairly because primary earners would be intentionally taxed more and secondary earners less in an attempt to benefit and encourage secondary earners to work. I take up two issues with respect to potential consequences in the execution of the optimal tax for the married couple. First, it appears as though the secondary earner could still be subject to relatively high tax rates depending on the primary earner’s marginal rate. If the secondary earner is still subject to relatively high tax rates and decides to stay home, the optimal tax would only have the effect of treating the primary earner of the household worse than before the additional taxes were imposed. Second, even if the secondary earner decides to work, the married couple may have less income overall depending on what the primary earner and secondary earner’s income is and their corresponding tax rates. The optimal tax proposal would also be unfair to single filers. If imposed, the Internal Revenue Code would be favoring secondary earners to

24 Cicconi, supra note 20, at 276; Zelenak, supra note 23, at 1023-1025.
25 Cicconi, supra note 20, at 276; Zelenak, supra note 23, at 1023-1025.
work over other individuals because only secondary earner tax rates would be reduced.
Moreover, single filers are their own primary earners, so they potentially could be taxed at higher
rates as well with no corresponding benefit to a secondary earner. Therefore, this policy is unfair
and should not be enacted.

Scholars have also proposed a mandatory individual filing or election to file individually.
This proposal has some merit because the secondary earner is no longer making decisions based
upon the primary earner’s marginal rate and is encouraged to work through the use of
deductions/credits and low tax rates.27 There are many problems, however, with separate filing
for married individuals. For example, determining how income, deductions and credits are
allocated between the spouses may be problematic.28 A determination of how to tax property
income would be especially difficult to administer because it would need to be determined
whether: 1) the owner of the property is taxed; 2) property income should be allocated equally;
3) property income should be allocated in proportion to the spouses earned incomes; 4) property
income should be allocated to the primary earner; or 5) property income is taxed according to
ownership and do not give any tax effect to inter-spousal property transfers.29 The allocation of
deductions and credits would also be difficult for the IRS to administer because it would have to
keep track of the deductions and expenses that each spouse is taking.30 The shortfalls of both the
optimal tax and separate filing proposals make it necessary for other options to be explored.
Therefore, this paper next addresses a novel proposal to resolve the marriage penalty & stacking
income effect, which influences the secondary earner’s decision to work.

27 Amy C. Christian, *The Joint Return Rate Structure: Identifying and Addressing the Gendered Nature of
28 Zelenak, *supra* note 8, at 381.
29 *Id.* at 384.
30 *Id.* at 391-92.
IV. Changing the Filing System

In lieu of the optimal tax and individual filing proposals, I propose that an election be made available on the joint return for the secondary earner to exclusively file wage income as a single filer. To take advantage of this opportunity the married couple would have to file as married filing jointly. It would not make sense for spouses to file married as separately and then elect to have the secondary earner’s wage income taxed at the single filer rates. On the joint return, the IRS could provide an election that would allow the secondary earner to file wage income (and only wage income) separately as a single filer. This would resolve the elasticity issue that stacking has on secondary earners because the secondary earner would not make the determination of whether to work based primarily upon income taxed at the primary earner’s marginal rate. Instead, the secondary earner could take advantage of the single filer low-rate structure. Therefore, the single-filer tax consequences to the secondary earner would not, to a certain extent, affect the decision to work. This would promote greater efficiency of the Internal Revenue Code because taxes would not be the driving factor in the secondary earner’s decision-making. In a similar fashion, this policy would help to alleviate the substitution effect that the primary earner’s marginal tax rates have on secondary earners.

This policy is more efficient than the optimal tax or individual filing proposals for several reasons. First, filing jointly is a necessary component because the couple would avoid the problems associated with filing individually as described above. From an administrative perspective, the policy promotes administrative ease because the IRS does not need to worry about issues related to income shifting, property income allocation or passive income allocation such as interest and dividends for joint filers. This is because everything other than the secondary earner’s wage income is filed with the joint return. Moreover, the secondary earner’s
final tax owed will be simple to administer because the tax rate is only applied against wage income. Additionally, the policy does not result in unfair treatment to the IRS because the IRS is getting the same amount of revenue it would have gotten from the joint return had the secondary earner chose not to work as a result of stacking incomes and being taxed at the primary earner’s marginal rate. Instead, the IRS will receive additional tax on the secondary earner’s wage income.

There are, of course, a few wrinkles associated with this policy. First, the IRS will need to determine when the married couple can file the election. The IRS could allow the election when the primary earner’s marginal tax rate reaches a certain level. This policy, however, is not fair because it would only benefit a specific group of individuals. Instead, the IRS should allow the election based on a proportion between the primary and secondary earner’s wage income. For example, the IRS could allow the election if the primary earner’s wage income is at least double that of the secondary earner.

Another issue that arises is what deductions and credits can be used for the joint return and single return. A fair result would be to allow the couple to itemize and take credits on the joint return as they normally would have and only allow the secondary earner to take a standard deduction on the single filing return. Lastly, marriage benefits should not be affected by this proposal. There are sure to be other problems associated with the policy but it is an option worth exploring.

Even if enacted, this policy would only help to resolve the affect that the primary earner’s marginal tax rate has on the secondary earner’s decision to work. There are other factors that affect the secondary earner’s decision to work—most notably is childcare expenses. With

31 NOTE – There are many issues with the secondary earner bias and the marriage penalty. This election does not address the merits of other concerns/issues and how they would affect the viability to this proposal other than to the extent of the concerns discussed.
childcare expenses reaching an average of $2,300/month in Manhattan\textsuperscript{32}, it is necessary for the government to offer deductions and credits to reduce the burden of such expenses. There are several policies currently in place to help offset childcare expenses. These include the § 21 Dependent Care Tax Credit ("DCTC") and the § 129 Dependent Childcare Assistance Program ("DCAP"). These policies, however, do not adequately offset the expenses of childcare.\textsuperscript{33} Therefore, in addition to my proposal to tax secondary earner’s wage income at single filer rates, I also propose that § 21 and § 129 are improved to further encourage secondary earners with children to work.

V. Amendments to Current Policies

The § 129 DCAP allows employees to take $5,000 of their pay, tax-free, including social security taxes, in the form of childcare services.\textsuperscript{34} The DCAP functions as a deduction, and therefore, only the DCAP or the § 21 DCTC may be elected.\textsuperscript{35} The problem with the DCAP is that the program requires an employer to establish the plan, and because many employers do not do so, only a small amount of employees have access to this provision.\textsuperscript{36} If the IRS prefers taxpayers to use this deduction over the DCTC, the IRS can offer the DCAP as a deduction proportionally to income of the taxpayer earned so that the deduction has the same effect as if the earner was receiving $5,000 tax-free to apply to applicable childcare expenses/services.

In addition, the § 21 DCTC allows for a credit equal to 35% for household and childcare expenses (reduced by 1% for each $2,000 by which the taxpayer’s adjusted gross income for the taxable year exceeds $15,000 but not below 20%) up to $3,000 for one child and $6,000 for two children.

\textsuperscript{33} McCaffery, \textit{supra} note 4, at 1007-1009.
\textsuperscript{34} 26 U.S.C. § 129 (a) (2012); McCaffery, \textit{supra} note 4, at 1007-1009.
\textsuperscript{35} McCaffery, \textit{supra} note 4, at 1007-1009.
\textsuperscript{36} Shurtz, \textit{supra} note 26, at 521-23; McCaffery, \textit{supra} note 4, at 1007-1009.
or more children.\textsuperscript{37} This provision, however, is “inadequate to offset the costs of working to pay for childcare”\textsuperscript{38} because childcare costs are extremely high and the total credit may hardly reach the amount of childcare expenses a family may incur. For example, the DCTC may not offset an upper-income family’s childcare expenses for a single month.

The DCTC can be improved in two ways. First, the applicable childcare expense amount should be increased by $3,000 for every child born.\textsuperscript{39} For example, if a family has four children, the applicable percentage should be applied to $12,000 of applicable household and childcare expenses. This is the fairest construction of the statute and there does not appear to be any administrative issues associated with this policy. Moreover, the phase-out should be stricken from the provision because the phase-out only perpetuates the issue that the credit is not accounting for childcare expenses appropriately.\textsuperscript{40} As the laws currently stand, the DCTC is the most important to improve because the DCAP only applies to employees of a company that offers the program.

VI. Conclusion

The Internal Revenue Code is currently operating inefficiently with respect to married individuals. For some married taxpayers, with their incomes pooled together, the Code imposes a marriage penalty because the married couple is taxed at higher rates sooner than single taxpayers are. The secondary earner’s income is determined to be “stacked” on top of the primary earner’s income and the secondary earner is taxed at the primary earner’s marginal rate—which can be very high. This marginal rate, in combination with other taxes imposed, can

\textsuperscript{38} McCaffery, supra note 4, at 1007-1009.
\textsuperscript{39} Cicconi, supra note 20, at 293-94 (author’s proposal expanded upon).
\textsuperscript{40} Cicconi, supra note 20, at 293-94 (author’s proposal expanded upon).
cause the secondary earner to choose to stay at home instead of working. Additionally, expenses such as childcare may also pose a great obstacle for some secondary earners to choose to work.

Taxing secondary earner’s wage income at single filer rates and improving the DCTC may encourage secondary earner’s to choose to work had they otherwise chose to stay at home as a result of taxes and expenses. Although, taken together, these proposals may not completely resolve the issue it is a step in the right direction.