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Avoiding The Marriage Penalty: The District's Rate Structure May Do More Harm Than Good

By Wes Rivers

Most state income tax systems — and the federal income tax system — apply their tax rates differently to different family types. This is done in part to avoid a "marriage penalty" that could lead to higher taxes on a married couple than they would have paid as two single filers. The most common way to address this is by having wider tax brackets for married couples than for singles. For example, a state could apply its lowest tax rate to the first $20,000 of income for a single person and the first $40,000 for married couples. The wider brackets for married couples also address the fact that expenses for a family with two adults are likely to be higher than for one adult.

The District has a method for avoiding the income tax marriage penalty, but it is confusing and inefficient. The District's income tax has one set of brackets and rates for all filers, regardless of filing status. This means that a married couple's joint income could be taxed at a higher rate than two single people with the same income. To address this, the District allows married couples to file separately based on each spouse's income, while keeping the information on the same return. This is referred to as "married filing separate on the same return" or "combined filing." While this helps married couples avoid a marriage penalty, it also creates several problematic inefficiencies:

- **Confusion for Eligible Families:** The ability to file separately on the same return may not be clear, and some married couples may not realize they have this option. Married couples that file jointly may still face a "marriage penalty" and wind up paying more in taxes than if they had filed separately on the same return or each had filed as single. In addition, some low-income married couples may not realize they are eligible for refundable tax credits, like the Earned Income Tax Credit (EITC), if they file separately on the same return. The District's tax return instructions are confusing with respect to credit eligibility and filing separately.

- **Challenges in Creating New Brackets:** The District created a new tax bracket for income above $350,000 in 2011. But, because two-earner families are allowed to split their income, this means that some families may not face the top tax rate until their income exceeds $700,000 – $350,000 for each spouse. Although it is likely that the DC Council intended the new tax bracket to apply to *families* earning more than $350,000, the reality is that for many high-income couples, the new bracket will not apply until their income hits a much higher threshold.

- **Limited Flexibility in Setting Brackets for Higher Income Families:** A number of states and the federal income tax system recognize that addressing marriage penalties and the needs of larger families is most important for low- and moderate-income families. These states have wider tax brackets for low and moderate-income married couples, but the brackets for singles and joint filers converge at higher income levels. This means the top tax bracket applies to income above a specified level that is the same for all family types. DC's single set of brackets does not allow for this flexibility.

One approach the District can take to solve these inefficiencies is to adopt separate bracket structures for each filing status, as is done in the federal income tax and in just over half of the states that levy income taxes. This approach is easier for families to understand and thus is the best way to ensure families get marriage penalty relief. It also offers flexibility to design tax rates and brackets for families at different income levels.

States Have Different Options for Addressing the "Marriage Penalty"

In general, larger families have higher financial needs than smaller families. To account for varying needs, all states apply income taxes differently by family size so that the tax liability for a two adult household at a given income level is lower than the taxes paid by a single person with the same income. Some states do this by using separate brackets for different filing statuses, others vary the size of exemptions and deductions, and some do a combination of both.

If states have a single set of brackets for all filing statuses, married couples who file jointly can end up paying more together than two single people with matching incomes. In DC, for example, two spouses who each make $25,000 will face a higher tax bill than two single people earning $25,000 each.[1] If their income is combined, for a total of $50,000, some of their income would be subject to DC's 8.5 percent tax rate, which starts when taxable income exceeds $40,000. Yet if two single people earning $25,000 each filed DC taxes, neither would have income subject to the 8.5 percent rate. This is known as the "marriage penalty."

The most common way to address the marriage penalty and to address the higher expenses of married couples — used in 22 states and in the federal income tax — is to set income tax brackets differently according to filing status. Tax brackets are wider for joint filers, meaning that married couples have to be at a higher income than a single person to pay the same income tax rate. (See the example of the federal income tax brackets in **Table 1**.) If the income bracket for each rate is twice the size for married couples filing jointly than it is for a single person, the marriage penalty is fully eliminated.

[1] This example does not take into account exemptions, deductions, or credits.

Table 1		
Federal Income Tax Bracket Structure		
Marginal Tax Rate	**Married Filing Jointly**	**Single**
10%	$0 - $17,000	$0 - $8,500
15%	$17,000 - $69,000	$8,500 - $34,500
25%	$69,000 - $139,350	$34,500 - $83,600
28%	$139,350 - $212,300	$83,600 - $174,400
33%	$212,300 - $379,150	$174,400 - $379,150
35%	$379,150 +	$379,150 +

Source: Internal Revenue Service Form 1040 Instruction for Filing Year 2011 (Federal).

Table 2 gives a breakdown of states and the various methods used to alleviate the marriage penalty. There are 41 states and the District that have an income tax. Of these, seven have only one income tax rate that applies to all income, which means there is no marriage penalty. In the remaining 34 states and DC, 22 address the marriage penalty by having wider tax brackets for married couples than for singles, though in somewhat different ways that do not necessarily eliminate the marriage penalty entirely for all families. These ways include:

- **Income tax brackets for married couples filing jointly that are twice the width of brackets for singles** (12 states). This approach ensures that a couple filing jointly will pay the same amount of tax as if each spouse had been able to file as a single person.[2] This eliminates the marriage penalty entirely.

- **Income tax brackets for married couples that are wider than for single filers, but not fully doubled** (5 states). This approach reflects recognition that the expenses for married couples are higher than for singles but not necessarily twice as high because of the economies of scale a larger family may enjoy. For example, rent or mortgage costs for a married couple may be higher than for a single person, but probably not twice as high. This approach means that the states still have slight marriage penalties. The exception is Minnesota, which has a tax credit offered to married filers that offsets the additional tax liability.

- **Income tax brackets for low- and middle-income married couples that are wider than for single filers, but converge the brackets at higher income levels** (5 states and the federal income tax). In these states and in the federal income tax, high income households face the same tax rates regardless of family type. This approach recognizes that marriage penalties are more problematic for low- and moderate-income households. New York, North Dakota, Vermont, and the federal income tax set wider brackets for joint filers compared to single filers at lower incomes and gradually converge the brackets and rates at the top of the income distribution. Maryland and New Jersey's brackets begin with the same rates and income

[2] Connecticut and Oregon have brackets for married couples filing jointly that are double the width of the brackets for single filers, but their income taxes still carry a small marriage penalty. In Connecticut, the standard deduction for a joint filer household is less than what it would be for the combination of two single filer households. Moreover, Connecticut's standard deductions phases out, and that happens more than twice as fast for married couples than for singles. Oregon carries a small marriage penalty because of its calculation for deducting federal income tax from taxable income.

Table 2				
Some 22 States Set Brackets Differently to Help Address the Marriage Penalty				
Filing separately or single have brackets half the width of filing jointly (12)	**Filing separately has brackets half the width of filing jointly, single is 60 to 75 percent of filing separately (5)**	**Flat rate, no brackets (7)**	**Single set of brackets (13)**	**Filing separately/single brackets converge w/ filing jointly brackets (5)**
Alabama	Georgia	Colorado	Arkansas	Maryland
Arizona	Minnesota	Illinois	Delaware	New Jersey
California	New Mexico	Indiana	District of Columbia	New York
Connecticut	North Carolina	Massachusetts	Iowa	North Dakota
Hawaii	Wisconsin	Michigan	Kentucky	Vermont
Idaho		Pennsylvania	Mississippi	Idaho
Kansas		Utah	Missouri	Kansas
Louisiana			Montana	
Maine			Ohio	
Nebraska			Rhode Island	
Oklahoma			South Carolina	
Oregon			Virginia	
			West Virginia	
Source: Filing Year 2011 Individual Income Tax Forms and Instructions for DC and 41 other states.				

thresholds for all filers at lower incomes, diverge in the middle of the income spectrum, and then converge again at the highest incomes.

North Dakota, Vermont, and the federal income tax also go one step further and set the brackets for married joint filers at double the width of married separate filer brackets throughout the entire income distribution. This limits the ability of the highest income married households to split their income and pay at lower rates compared to single and joint filing households with the same income.

The remaining 12 states and the District do not address the marriage penalty through having separate brackets for married couples and singles. DC and these states have a single set of brackets that apply to all filers, and they address the marriage penalty in various ways and to various degrees.

- In seven of these states and the District, married filers can choose to file separately even if they file jointly on their federal return, giving them the ability to avoid the marriage penalty.[3] With one exception, all of these states and DC add even more filing flexibility by allowing couples to file separately on the same return, so that the couple can receive one tax refund or pay one tax payment and still claim credits for dependent child care expenses.[4]

[3] Missouri does not allow couples to file income jointly, couples must choose between filing separately or filing separately on the same return (known as filing combined).

[4] Montana is the only exception where couples are allowed to file a different status on their federal and state returns, but the state does not allow couples to file separately on the same return.

- In four of these states, a couple generally must file their state income tax return using the same status as they did when filing their federal return. This means a couple would have to file separately at the federal level to avoid the marriage penalty at the state level. Yet filing separately at the federal level often is the least desirable filing status because it limits the ability to claim certain credits. In these states, then, many married couples are not able to avoid the marriage penalty.

- West Virginia has a single set of brackets for both single and married filers, but it has no mechanism in its rate and bracket structure to reduce the marriage penalty.

The District's Current Bracket Structure Creates Inefficiencies

The District's option to allow married couples the ability to file separately on the same return accomplishes the goal of eliminating the "marriage penalty." However, this method also creates confusion and leads to several inefficiencies in the income tax system.

The Ability of Married Couples to File Separately is Not Transparent; Couples That File Jointly May Still Be Hit By the "Marriage Penalty"

Most married couples file jointly on their federal return and may assume that is the filing status to use in their DC return as well. Some married couples may not be aware of the ability to split their income and be taxed as individuals through the "married filing separately on the same return" filing status, which is not a federal filing option and sounds confusing. Couples who do not know that they are able to file separately on the same return may be hit by the District's marriage penalty due to the single set of income tax brackets.

In addition, low-income couples filing separately in the District cannot receive the DC Earned Income Tax Credit (EITC), but if they file separately on the same return they are eligible. The language on the District's tax return instructions states that married couples filing separately cannot claim the EITC. Because of the confusion surrounding "married filing separately on the same return," eligible families interested in applying for the credit may not realize they are eligible if they file separately on the same return.

A Single Income Tax Bracket Structure Can Create Challenges For Implementing New Brackets

When the DC Council increased the top income-tax rate on income over $350,000, it is likely that they intended to increase the tax on *families* earning $350,000 or more. However, because of the ability for DC married couples to split their income, the reality is that two-earner families may not be subject to the higher rate until their income exceeds $700,000.

A Single Income Tax Bracket Structure Limits Flexibility to Adjust Brackets for Different Family Types and Different Income Levels

As noted, a number of states have wider tax brackets for married couples than singles at low or middle-income levels, but converge the brackets at high-income levels. This is done because the need to address the marriage penalty is most important for low- and middle-income families and it is not as critical to provide that tax relief to higher-income families. By contrast, DC's combined filing separately status provides marriage penalty assistance to families at all income levels. Because tax rates are highest for the top income families, the largest marriage penalty assistance goes to high-income couples.

The District Should Implement New Income Tax Bracket Structures

This review suggests that the District should create a new set of tax brackets that vary by family type, to make its income tax more transparent and to create more flexibility over how income taxes are applied to families at different income levels. This is the approach taken in most states with an income tax that has multiple brackets. There are two models that appear to make the most sense for the District.

Set Income Tax Thresholds at a Given Rate for Married Couples Filing Jointly at Twice the Size of Those for Single Filers

Twelve states set the width of income brackets for a married joint filers at exactly twice the width for single filers.[5] Two single people's income is taxed at a similar rate to that of a couple who combines their income and files jointly — thus, completely eliminating the marriage penalty. An illustrative example of how the District could implement this structure is shown in **Table 3.**[6] Under this proposal, the District's current brackets would be used as the brackets for single filers and married couples who file separately, and the brackets for married couples filing jointly would be doubled. This means that for married couples that file "married filing separate combined on the same return," their tax liabilities would remain unchanged.

This proposal takes a different approach for the top tax bracket — the 8.95 percent rate for income above $350,000. Rather than use this as the bracket for singles and then doubling it for married couples filing jointly — this proposal would apply the $350,000 threshold for joint filers and set the threshold at half of that level ($175,000) for single and separate filers. While this would lead to a modest increase in taxes for single filers with incomes above $175,000, this structure is consistent with the likely intent of the DC Council when it created the 8.95 percent bracket — namely that the new tax rate should apply to families with incomes above $350,000. The alternative, setting the 8.95 percent bracket at $350,000 for singles and $700,000 for married couples, does not seem consistent with the Council's intent.

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[5] Oklahoma is the only exception, where filing separately thresholds are twice the single thresholds at the lower end of the income spectrum, but then decreased to less than half at the highest threshold.

[6] While DCFPI believes that an adjustment to the income tax brackets and rates are needed, Tables 3 and 4 are only illustrative and do not reflect a recommendation on the specific rates and income levels needed in a new bracket structure.

Table 3		
“Half Bracket” Structure In DC		
Marginal Tax Rate	**Married Filing Jointly**	**Single and Married Filing Separately**
4%	$0 - $20,000	$0 - $10,000
6%	$20,000 - $80,000	$10,000 - $40,000
8.5%	$80,000 - $350,000	$40,000 - $175,000
8.95%	$350,000 +	$175,000 +

Set Wider Brackets for Low- and Middle-Income Joint Filers, and Converge Bracket for Higher-Income Residents

Five states eliminate the “marriage penalty” by using separate brackets for each filing status that converge at higher income levels. This method recognizes that marriage penalties have a greater impact on low- and moderate-income households and that the importance of providing marriage penalty relief diminishes as income increases. If the District moves to having separate brackets for married couples and singles, setting the top bracket at the same threshold for all family statuses could help limit the potential loss of revenue from this change. (See **Table 4**.) Under this proposed option, the top tax bracket would start at $350,000 of income regardless of family status. This means that some two-earner families with combined income above $350,000 – who currently do not face the top tax rate because they split their income — would be subjected to the top income tax rate. The example below adds a new tax bracket only to illustrate convergence.

If the District takes this approach, the brackets for married couples who continue to file separately would need to be carefully considered. At the federal level and in many states, brackets for separate filers are set at exactly half the size of the brackets for married people filing jointly. This is done to eliminate any financial incentives for married couples to file separately, so that this filing status is used mainly by married couples who have difficulty filing together — such as those who are legally separated. The District should do the same, by setting its brackets for married filing separately at half the size of brackets for married couples filing jointly.

Table 4			
Converging Bracket Structures In DC			
Marginal Tax Rate	**Married Filing Jointly**	**Singles**	**Married Filing Separately**
4%	$0 - $20,000	$0 - $10,000	$0 - $10,000
6%	$20,000 - $80,000	$10,000 - $40,000	$10,000 - $40,000
8.5%	$80,000 - $175,000	$40,000 - $100,000	$40,000 - $87,500
8.75%*	$175,000 - $350,000	$100,000 - $350,000	$87,500 - $175,000
8.95%	$350,000+	$350,000+	$175,000 +

*The 8.75 percent marginal tax bracket was constructed for illustrative purposes only.

With a single set of brackets for all filing statuses, the District complicates filing for married couples, fails to target relief from the marriage penalty to those that need it the most, and limits flexibility for the District to implement new brackets. The District is an outlier with respect to rate and bracket structure — as 22 states recognize the need to have transparency and flexibility in their rate and bracket structure.

Creating a new set of brackets for different filing statuses can help DC remove the "marriage penalty" in a way that is more transparent. In addition, separate brackets also provide an opportunity for the District to target relief to those who need it most.