NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: HB 1304 (First Edition)

SHORT TITLE: No Income Tax Marriage Penalty

SPONSOR(S): Rep. Decker, et al.

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ( )**

($Million)

	FY 1999-00	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04
REVENUES					
General Fund				($144.4)	($99.8)

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue

EFFECTIVE DATE: The act is effective for taxable years beginning on or after January 1, 2002.

BILL SUMMARY: The bill increases the standard deduction and the income tax brackets for married filing jointly taxpayers equal to twice the amount for single taxpayers. The bill also changes the tax brackets for those married individuals filing separately to the same tax brackets of single filers.

BACKGROUND: The term “marriage penalty” refers to the income tax situation where married individuals filing jointly pay more in tax than if the two individuals were unmarried filing as single persons. In its 1997 report entitled “For Better or Worse: Marriage and the Federal Income Tax”, the Congressional Budget Office estimated that 20 million married couples in the U.S. pay higher taxes than they would if they were single. On the other hand, the report also showed that 25 million American couples enjoyed a marriage bonus because their taxes were lower as a result of marriage. The marriage penalty is greatest on couples with two wage earners with similar incomes. Statistics from the U.S. Bureau of the Census show the labor force participation rate among married women has grown from 41% in 1970 to 61% in 1996 increasing the number of two-earner couples. Further contributing to the marriage penalty was the 42% growth in the median income of married women from 1974 to 1996.

The American Institute of Certified Public Accountants believes the two biggest factors creating the marriage penalty are 1) the stacking of income problem and 2) the different income thresholds and phase-outs for deductions and credits for single versus married taxpayers. There are nine bills pending in the 106th Congress that attempt to erase the marriage penalty. Congressional bill H.R. 6, The Marriage Tax Elimination Act, increases the tax brackets and standard deductions for married couples to twice that of singles. In North Carolina, the proposed HB 1304 also addresses the income tax brackets and the standard deduction which favor those filing as single taxpayers rather than those in the married filing jointly category.

ASSUMPTIONS AND METHODOLOGY: One solution at least eight states have used to eliminate the marriage penalty in their state income tax is to have the married tax brackets double the width of the single tax brackets. This strategy will also work in North Carolina. The current North Carolina tax brackets are as follows:

	Single	Married
6%	0 to $12,750	0 to $21,250
7%	$12,751 to $60,000	$21,251 to $100,000
7.75%	$60,001 >	$100,001 >

Half of the penalty can be reduced by changing the married tax brackets to equal twice the value of the single brackets as proposed by HB 1304 and shown below.

	Married – HB 1304
6%	0 to $25,500
7%	$25,501 to $120,000
7.75%	$120,001 >

A second way to reduce the marriage penalty is to increase the standard deduction for married filing jointly to an amount twice the single rate. The calculation of state income tax begins with the federal taxable income computed on the federal form 1040. However, before the state income tax can be computed, federal taxable income must be adjusted for state personal exemptions and standard deductions. The state personal exemption and standard deductions have not been indexed to keep pace with inflationary changes in the federal rates. For tax year 1998, the state exemption rate is $2500 and the federal rate is $2700, thus $200 must be added back to taxable income for each dependent. (For the 7.75% tax brackets, $700 per exemption must be added back.) The state standard deduction for singles is $3000, but the federal deduction in 1998 is $4250 thus $1250 must be added back to taxable income. For married filing jointly, the state standard deduction is $5000, but the federal deduction is $7100, thus $2100 is added back to taxable income.

Without the changes proposed by HB 1304, two of the three married couples in the example below will pay more than unmarried couples with similar incomes.

	Two Singles each earn $30,000	Married each earn $30,000	Two Singles 1 earns $30,000 1 earns $20,000	Married 1 earns $30,000 1 earns $20,000	Two Singles 1 earns $90,000 1 earns $20,000	Married 1 earns $90,000 1 earns $20,000
Fed. Tax Income	$46,100	$47,500	$36,100	$37,500	$96,100	$97,500
Add back	2,900	2,500	2,900	2,500	3,400	3,500
NC Tax Income	49,000	50,000	39,000	40,000	99,500	101,000
NC Tax	$3,175	$3,286	$2,475	$2,589	$6,898	$6,865
Difference		$111		$114		-$33

With a proposed $6,000 standard deduction for married filing jointly, the add-back will be $1100 for the standard deduction and $400 for two personal exemptions, or $1500. (The add-back is greater for those exceeding the income cap for personal exemptions.) The chart below applies the tax brackets and standard deductions proposed by HB 1304 in tax year 1998. HB 1304 would erase the marriage penalty or would create a small marriage bonus for some couples.

	Two Singles each earn $30,000	Married each earn $30,000	Two Singles 1 earns $30,000 1 earns $20,000	Married 1 earns $30,000 1 earns $20,000	Two Singles 1 earns $90,000 1 earns $20,000	Married 1 earns $90,000 1 earns $20,000
Fed. Tax Income	$46,100	$47,500	$36,100	$37,500	$96,100	$97,500
Add back	2,900	1,500	2,900	1,500	3,400	2,500
NC Tax Income	49,000	49,000	39,000	39,000	99,500	100,000
NC Tax	$3,175	$3,175	$2,475	$2,475	$6,898	$6,745
Difference		0		0		-$153

The North Carolina Individual Income Tax Model was used to estimate the cost of changing the standard deduction and income tax brackets of married filing jointly to twice that of single filing status. The model projects the tax year cost of eliminating the marriage penalty as follows:

Tax Year 2002	($95.3 million)
Tax Year 2003	($98.2 million)
Tax Year 2004	($101.3 million)

The first year impact in FY 2002-03 includes the General Fund revenue loss for tax year 2002 and half the loss for tax year 2003 (January - June 2003) due to taxpayers adjusting their withholding tables and estimated payments. The remaining fiscal years equal half of one tax year plus half of the next tax year.

FY 1999-00	
FY 2000-01	
FY 2001-02	
FY 2002-03	($144.4 million)
FY 2003-04	($99.8 million)

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